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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1944

No. 81

OTIS & CO., PETITIONER,

vs.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED MAY 11, 1944.

CERTIORARI GRANTED JUNE 12, 1944.

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

Appendix to Brief for Appellant

In United States District Court, District of Delaware

Relevant Docket Entries

Apr. 16, 1943. Complaint filed.

Apr. 16, 1943. Order of Court setting this cause down for hearing June 15, 1943, at 10:00 A. M., and ordering United Light and Power Co. to give notice to certain stockholders, filed.

June 12, 1943. Proposed answer of Otis & Company; same day motion to file proposed answer with affidavit attached, filed.

June 15, 1943. Hearing on S. E. C. plan under Sec. 11(b).

July 30, 1943. Opinion re intervention of Otis & Co. and approval of plan, filed.

Aug. 4, 1943. Order permitting Otis & Co. to file objections and be heard nunc pro tunc, filed.

Aug. 4, 1943. Order confirming plan as fair and equitable, etc., filed.

Aug. 25, 1943. Notice of Appeal by Arthur G. Logan for Otis & Co., filed (copies sent to 3rd C. C. A., Roger S. Foster of S. E. C. and Clarence A. Southerland for United Light & Power), filed.

Aug. 25, 1943. Appeal Bond of Otis & Co., with Fidelity & Deposit Co., as surety in amount of $250.00, filed.

Sept. 22, 1943. Statement of Point on which Appellant intends to rely on appeal, filed.

Sept. 22, 1943. Designation of Contents of Record on Appeal, filed by Appellant.

[fol. 2] Oct. 2, 1943. Designation of Contents of Record on Appeal by Appellee, filed.

Oct. 2, 1943. Stipulation and order re original exhibits re record on appeal, filed.

Oct. 4, 1943. Motion of Appellant; same day order extending time for filing record on appeal until Oct. 14, 1943.

Oct. 4, 1943. Order correcting opinion of July 29, 1943, filed.

[fol. 3] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

FINDINGS AND OPINION—April 1, 1943

Simplification of Holding Company System

Plan Under Section 11 (e) "Necessary to Effectuate Provisions of 'Section 11 (b)' "

Where a plan filed under Section 11 (e) of the Act provides for action ordered to be taken under Section 11 (b), and is a suitable means of achieving results which are necessary to effectuate the requirements of that section, *held* that the plan is "necessary to effectuate the provisions of" Section 11 (b) within the meaning of Section 11 (e).

Meaning of "Fair and Equitable" Standard in Section 11 (e)

Where Section 11 (b) (2) requires corporate simplification by means of liquidation, the "fair and equitable" standard requires the distribution of assets to preferred and common stockholders on the basis of legitimate investment values existing apart from the duty of liquidation.

Application of "Fair and Equitable" Standard in Section 11 (e) to the Proposed Distribution of Assets

Under the particular circumstances presented, the "fair and equitable" standard requires disapproval of an allocation to the common stock of in excess of approximately 5% of the assets to be distributed where such common stock has only a possibility of participation in future earnings.

APPEARANCES:

Louis F. Davis, John W. Christensen and Charles Futterer for the Public Utilities Division of the Securities and Exchange Commission.

[fol. 4] Donald Richberg, of Washington, D. C., John Dern and Robert A. Olson, of Chicago, Illinois, for The United Light and Power Company.

Arthur S. Dayton, of Charleston, West Virginia, for Koppers Company.

The United Light and Power Company ("Power") and its subsidiary company, The United Light and Railways Company ("Railways"), both registered holding companies, have filed with the Commission joint applications and declarations, designated as "Application No. 14", pursuant to Sections 11 (b) and 11 (e) of the Public Utility Holding Company Act of 1935 ("the Act") for approval of a plan designed to effectuate the dissolution of Power in compliance with our order of March 20, 1941.[1] In summary, the plan provides for the contribution of cash and minor investments of Power to Railways, and the distribution of Power's remaining asset consisting of all the outstanding common stock of Railways among the preferred, Class A and Class B common stockholders of Power, after which Power will be dissolved.

After appropriate notice, hearings were held on the plan. Applicants waived their rights to oral argument, to submit requests for findings of fact, and to file briefs with respect to the issues raised in the proceeding. Having considered the record, the Commission makes the findings hereinafter set forth.

Brief Description of Applicants

The Power holding company system, as constituted as of November 1, 1942, is shown in the corporate chart attached as Exhibit A. Power, the top company in the system, is solely a holding company owning as its chief asset all the common stock of Railways, also solely a holding company. Following is a condensed corporate balance sheet of Power, per books, as of April 30, 1942.

[1] *The United Light and Power Company*, Holding Company Act Release No. 2636.

[fols. 5-6]

The United Light and Power Company

Condensed Corporate Balance Sheet as of April 30, 1942

Assets			
Investments:			
Railways Common Stock		$72,596,138	
Directly Owned Operating Subsidiaries:			
La Porte Gas and Electric Company	$2,462,535		
Mason City and Clear Lake Railroad Company	1,309,491		
	$3,772,026		
Less: Reserve	352,792	3,419,234	$76,015,372
Deferred Charges			161,680
Special Deposit in Escrow			1,358,442a
Current Assets:			
Deposit for payment of principal and interest on debentures payable 5/1/42		$2,976,186b	
Other (principally cash of $534,080)		647,395	3,623,581
Total Assets			$81,159,075
Liabilities			
Capital Stock:			
Class A Preferred — 600,000 shares — (Liquidation Value $100 per share)		$60,000,000c	
Common (stated value $4 per share):			
Class A — 2,421,192 shares	$9,684,768		
Class B — 1,055,576 shares	4,222,304	13,907,072	$73,907,072
Current Liabilities:			
Bank Note Payable		$3,000,000d	
Debentures (Principal and Interest)		2,976,186b	
Miscellaneous		156,790	6,132,976
Reserve for Depreciation of Investments			2,962,859
Surplus (Deficit)			(1,843,832)
Total Liabilities			$81,159,075

a This sum, equal to the premium payable on voluntary redemption of the debentures, was deposited in escrow with Central Hanover Bank and Trust Company, in accordance with our order of February 25, 1942, and will be returned to Power or its assignee unless it is determined on review of our order that the debenture holders are entitled to receive the premium. On November 12, 1942 the United States Circuit Court of Appeals, Second Circuit, affirmed our order that the premium should not be paid. *The New York Trust Company* v. *Securities and Exchange Commission*, 131 F. 2d, 274 (C. C. A. 2d, 1942). The Trust Company petitioned the United States Supreme Court on February 27, 1943 to grant a writ of certiorari. In the event such petition is denied, or, if granted, the decision of the Circuit Court is affirmed, the funds in escrow will thereupon become available to Power and, under the plan, will be assigned to Railways.

b Deposited with Trustees on February 25, 1942 for payment of principal of and interest on debentures.

c Cumulative preferred stock dividends in arrears amounted to $36,300,000 as of April 30, 1942 and $38,700,000 as of December 31, 1942.

d This note was reduced to $1,500,000 during December 1942.

[fol. 7] Railways, the common stock of which is wholly owned by Power, owns securities of companies which operate, or which control additional companies which operate, gas and electric utility and certain non-utility properties located in scattered areas of the middle western and north central sections of the United States. By reason of this geographical scatteration, the system is at variance with the integration standards prescribed by Section 11 (b) (1) of the Act. Similarly, the existence of several tiers of holding companies in the system is repugnant to the "great-grand-father" clause and other requirements of Section 11 (b) (2). Accordingly, we have previously issued orders to various of the system companies directing action which we considered appropriate under both Sections 11 (b) (1) [2] and 11 (b) (2),[3] reserving jurisdiction, however, to continue proceedings under such sections and to enter such further orders as may be necessary or appropriate.

Detailed description of the substantial progress already made in carrying out our orders under Section 11 (b) (1) [4] and Section 11 (b) (2) [5] is not necessary here. It is sufficient for our present purposes to state that the plan under consideration represents only a part of a long-range program for effecting compliance with Section 11 (b) of the Act and is the final step in fulfilling the portion of our order of March 20, 1941 requiring the liquidation and dissolution of Power.

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[2] *The United Light and Power Company*, Holding Company Act Release No. 2923.

[3] *The United Light and Power Company*, Holding Company Act Release No. 2636.

[4] These steps were briefly reviewed in *The United Light and Power Company*, Holding Company Act Release No. 3741 and were described in detail in Holding Company Act Releases Nos. 2991, 3316, 3667, 3688 and 3892.

[5] Transactions already completed and steps remaining for consumption were referred to briefly in *The United Light and Power Company*, Holding Company Act Release No. 3438; and were more fully described in Holding Company Act Releases Nos. 2991, 2819, 3140, 3198, 3242, 3285 and 3345.

The Proposed Plan

Briefly stated, the plan provides for (1) the distribution of Railways' common stock, all owned by Power, to [fol. 8] Power's preferred and common stockholders; (2) the assumption of Power's liabilities by Railways; and (3) the transfer of Power's remaining assets to Railways, following which (4) Power will be dissolved.

Prior to the distribution of Railways' common stock and in aid of such distribution, the authorized common stock of Railways, now consisting of 1,000,000 shares having a par value of $35, will be increased to 4,000,000 shares with a par value of $6, each share to have one vote. The outstanding 708,520 shares of Railways' common stock will then be exchanged by Power for 3,947,677 shares of Railways' new stock. The proposed change in the par value of Railways' common stock will reduce the amount of capital represented by such stock outstanding from $24,798,200 to $23,686,062 and the difference of $1,112,138 will be credited to Railways' paid-in surplus account.

Following the above-described exchange, the plan provides that the new common stock of Railways be allocated to Power's security holders, in full compensation for their claims against Power, on the basis of 6 shares for each present share of Power's preferred stock, 1/10 share for each present share of Class A common stock and 1/10 share for each present share of Class B common stock of Power.[6] In lieu of fractional shares it is proposed that non-interest bearing, non-dividend bearing and non-voting scrip, in bearer form, will be issued; scrip in amounts sufficient to aggregate one or more full shares may be surrendered in exchange for full shares of Railways' common stock. The plan provides that the right of Power's stockholders to receive either common stock or scrip of Railways shall ex-

[6] Except as to voting rights, all of which are now vested in the Class B common, the Class A and B common stocks of Power are entitled to the same rights. For this reason the two classes of common stock will be considered together in our discussion of the fairness of the plan. The record shows that Power's common stocks, having an aggregate stated value of approximately $13,911,000, were issued for a total consideration of $28,482,745 of which approximately $17,121,000 represented cash.

pire July 1, 1944, after which date the scrip shall be void. All shares of Railways' common stock remaining unclaimed [fol. 9] as of this date shall be disposed of either at public or private sale and cash shall be distributed to the remaining stockholders of Power on the basis of their aliquot portion of the net proceeds of such sale plus any other cash from dividends or distribution which may be applicable to the common stock of Railways which may be sold.

The proposed exchange of securities will result in a distribution of Railways' new common stock as follows:

To Stockholders of Power	Outstanding Shares of Power (4/30/42)	Number of Shares of Railways' New Common To be exchanged for each share of Power stock	To Be Outstanding	Percent of Allocation of Railways' Common Stock
Preferred	600,000	6 for 1	3,600,000	91.20%
Class A Common	2,421,192	1 for 10	242,119	6.13
Class B Common	1,055,576	1 for 10	105,558	2.67
Total	4,076,768		3,947,677	100.00%

In accordance with our orders of August 5, 1941 and January 5, 1942[7] requiring disposition by Power of its investments in its directly owned operating subsidiaries, La Porte Gas and Electric Company ("La Porte") and Mason City and Clear Lake Railroad Company ("Clear Lake"), Power has attempted to sell these companies. Negotiations are at present in progress with respect to La Porte but a purchaser for Clear Lake has not yet been found. Under the plan it is proposed to retire Power's bank loan, in the [fol. 10] amount of $1,500,000, out of the proceeds from the sale of La Porte. In the event this sale is not consummated within the time scheduled for liquidation, Power's invest-

[7] *The United Light and Power Company*, Holding Company Act Releases Nos. 2923, 3242 and 3285.

ment in La Porte will be transferred to Railways, and appropriate arrangements will be made to provide for Power's bank loan and any remaining liabilities, including the expense of liquidation. The investment in Clear Lake and the remaining cash of Power will also be transferred to Railways as a capital contribution.[5]

The present voting rights of the stockholders of Power will not be affected by the plan until the date of distribution of Railways' common stock, at which time all voting rights in the stock of Power will cease and terminate. After the distribution date the present stockholders of Power will exercise the voting power which will attach to the Common shares of Railways to be received by them under the plan.

Power has requested the Commission, pursuant to Section 11 (e) of the Act, to apply to a Federal Court to enforce and carry out the provisions of the plan if and as approved by the Commission. If the Court approves the plan, the distribution of Railways' common stock and scrip to the stockholders of Power is to be made on or after the thirtieth day following the date on which the court decree becomes final and is no longer subject to review on appeal. Thereafter Power will be dissolved. The plan does not provide for approval by stockholders.

Compliance With Section 11 (e) of the Act

As a condition precedent to granting our approval of a plan such as this we are required by Section 11 (e) of the Act to find (1) that the plan is necessary to effectuate the provisions of Section 11 (b) and (2) that the plan is fair and equitable to the persons affected by it.

[fol. 11] *Necessity for the Plan*

We encounter no difficulty in making the first of these required findings. The plan provides for the liquidation and dissolution of Power, which we have previously found necessary under Section 11 (b) (2) of the Act, and dissolution is to be preceded by the elimination of Power's stock

[5] Power's investment in Clear Lake, now carried at a net amount of $591,154, is to be recorded on the books of Railways at $150,000 as a result of a proposed write-down by Power in the amount of $441,154.

liability through a distribution of assets in kind, a method we believe to be both economical and appropriate to effecing compliance with the standards of Section 11 (b) of the Act.

Fairness and Equitableness of the Plan

The second required finding, namely, that the plan is "fair and equitable to the persons affected by such plan," presents a more difficult problem. The assets of Power are, in our opinion, of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942.

Attached hereto as Exhibits B and C are corporate and consolidated balance sheets of Railways, as of April 30, 1942, per books and pro forma reflecting consummation of the proposed transactions. These balance sheets indicate a pro forma book value of $77,954,874 for Railways' common stock on a corporate basis and $81,554,330 on a pro forma consolidated basis. Thus present book values of assets pro forma are clearly insufficient to cover the liquidation preference of Power's preferred stock. Similarly, on the basis of a capitalization of reasonably anticipated earnings of the enterprise[9] we are unable to find an over-all value for the assets which approaches $98,700,000.

We are constrained to reach this conclusion as to asset values despite valuation testimony in the record including a study prepared, on behalf of the management, by an [fol. 12] engineer who derived an over-all value of $104,172,231, as of December 31, 1939, based upon a method involving the capitalization of his estimate of the earning power of the system. The company brought this valuation down to April 30, 1942, arriving at an over-all value of $110,000,000.

We have carefully considered the valuation study made by the engineer and without commenting in detail upon the propriety of the methods used, it is our opinion that

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[9] It is clear that capitalization of prospective earnings, rather than book values, is the principal criterion of asset value. *Consolidated Rock Products v. DuBois*, 312 U. S. 510.

the over-all valuation arrived at by the engineer must be rejected.[10] Our reasons for rejecting his valuation include consideration of the fact that we are here dealing with a regulated industry and that current trends in regulation place increased emphasis on depreciated cost of properties which, as indicated by the book values, is substantially less than the liquidation preference of the preferred stock. In order to show a value of as much as $98,700,000, it would be necessary to capitalize 1942 consolidated net earnings applicable to the common stock of Railways (the highest earnings since 1931) at a rate of 6.9%, a times-earnings

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[10] In making his study, the engineer first estimated the reasonably expected gross income of each subsidiary operating company. These estimates closely approximated estimates of sound earning power made by the management in a study completed in 1939. As the next step, the engineer calculated a return of 6% on an estimated earnings base computed for each company by taking estimated reproduction cost new less observed depreciation and adding thereto estimated necessary working capital. Following these steps, the computed return on the estimated earnings base was compared with estimated gross income and whichever earnings figure was lower in amount for each company that figure was capitalized at rates varying from 5.5% to 6% for electric and 6% to 7% for gas revenues. If, in this comparison, gross income exceeded the computed return on the estimated earnings base, the excess was capitalized at 10%. Gross income from transportation and miscellaneous services was capitalized at from 8% to 10%. The variation in capitalization rates used in the study was based upon a judgment as to the integrity of earning power as related to the character of the individual companies and the territory served, earnings history, population trends, competition, rates and other factors considered relevant. From the capitalized value obtained in the foregoing manner there was deducted an amount deemed necessary for materials, supplies and working capital, the remainder representing the estimated value of utility plant. This value was substituted for the net property accounts in the balance sheets of the various companies after which the over-all value of the ultimate holding company interest was computed in the usual manner for determining book equity.

ratio of 14.5. Even if the most liberal estimate of earnings made by the management, in the amount of $7,000,000, be taken as the measure of prospective earning power, cap- [fol. 13] italization of such earnings at a rate producing a times-earnings ratio of 14.1 is necessary to reach an overall value of $98,700,000. Further discussion of historical and prospective earnings appears below. In the light of all the circumstances, we conclude that on no reasonable basis for capitalizing prospective earning power could we arrive at a valuation equal to the liquidation preference.[11]

If the amount of the liquidation preference of the preferred stock ($100 per share plus accumulated dividends) is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common. Power's corporate charter provides that the liquidation preference of this stock shall come into operation in the event of "involuntary" liquidation. While the liquidation in this case is doubtless "involuntary," it is of a type that could not have been foreseen by the draftsmen of the corporate charter or by investors in the stock,

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[11] Without wishing to overemphasize the significance of market quotations in dealing with problems of valuation, we note that the times-earnings ratio at which 1942 consolidated net earnings must be capitalized, in order to find a value of as much as $98,700,000, is considerably in excess of the ratio the market, over the past five years, has placed on the common stocks of nine representative public-utility holding companies. The companies selected are all free of preferred dividend arrearages. The average times-earnings ratios (based on consolidated earnings) for these companies were as follows:

1937	12.5
1938	10.3
1939	10.1
1940	8.8
1941	6.5
1942	5.1
1943	7.1
Average for 4 years—1937-1940—	10.4
" " 5 " —1937-1941—	9.6
" " 6 " —1937-1942—	8.9

long before the enactment of the Holding Company Act.[12] [fol. 14] The question, then, is whether or not it would be "fair and equitable", in light of the legislative purpose and policy underlying Section 11 of the Act, to give controlling effect to that charter provision under the circumstances.

We have found no judicial precedents which are determinative of the precise question before us. Decisions like those in the Los Angeles Lumber[13] and Boyd[14] cases are predicated on sets of facts fundamentally distinguishable from the situation arising here. In bankruptcy or equity reorganizations, where some financial disaster overtakes or threatens to overtake an enterprise, the courts and Congress have proceeded on the theory that it is often in the interest of creditors and other claimants that the enterprise be permitted to continue in operation, but with a new capital structure. Creditors and other claimants are prevented from foreclosing or otherwise compelling an actual liquidation, but new securities are distributed among them according to their contractual and other rights determined *as though in liquidation*. The historical background of this approach is so familiar as to need no elaboration here.

On the other hand, Power is a company virtually without debt and under no financial embarrassment in the traditional bankruptcy or equity sense. Since it falls into a category of holding companies which Congress has determined must *not* be permitted to continue in operation, in

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[12] The preferred stock was created in 1929, six years prior to the passage of the Act. We think that involuntary liquidation, in the context in which that term is used in the corporate charter, connotes an act of default, either financially or in respect of conduct, on the part of the corporate management representing the common stock. In short, it contemplates protection of the preferred stock from business risks such as ordinarily attend equity investment. We do not, however, rest our decision upon this interpretation, as will be more fully developed *infra*, but only point out that the draftsmen of the charter could not have had Section 11 of the Act in mind.

[13] *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106.

[14] *Northern Pacific Railway Co. v. Boyd*, 228 U. S. 482.

the interests of the public, investors and consumers, the company's security holders are prevented from maintaining their respective interests in a going corporation. In our view, it is not inconsistent with the bankruptcy and equity precedents to conclude that in reorganizations or liquidations to comply with Section 11, stockholders affected should be given participations according to their contractual or other rights determined *as though in a continuing enterprise*, and that the process of compliance with the statute should not be permitted to mature liquidation [fol. 15] preferences. In both instances the measure of participation allowed should compensate for the substantive rights of security holders as they would exist apart from the reorganization or other procedure in question.

In the case before us, the duty to liquidate arises solely by virtue of a sovereign act, and in giving effect to the Congressional mandate we must not allow the liquidation itself to add value to one class of securities at the expense of another class.[17]

Where simplification of a system is to be attained through elimination of an unnecessary corporate entity, it is our opinion that the "fair and equitable" standard does not require us to consider liquidation rights as having matured, and as the sole measure of participation for the preferred stockholders; and it should be immaterial whether the simplification process takes the form of recapitalization, merger or distribution of the assets of a holding company in liquidation. In other words, the "fair and equitable" standard requires the same recognition of substantive rights irrespective of the method employed in a particular case for attaining the objectives of Section 11 (b) (2).

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[17] Cf. *The United Light and Power Company*,—S. E. C. — (1942), Holding Company Act Release No. 3345 (aff'd *The New York Trust Co. v. S. E. C.*, 131 F. (2d) 274 (C. C. A. 2d, November 12, 1942), in which we applied this reasoning to the liquidation of Power's debentures at par and accrued interest without premium. Our decision was based on the absence of any provision in the debenture agreements giving the holders a contract right to a premium under the circumstances presented. Thus we were not called upon to decide, and did not consider, what effect would be given to such a contract right if it had existed.

More specifically, if a class of preferred stock has a measurable interest in an enterprise absent the maturing of liquidation preferences and a proportionately greater interest upon the maturity thereof, it would not be fair or equitable under the statute to give recognition to the greater interest at the expense and to the detriment of the common stock. And conversely, if the common stock has a measurable interest apart from the maturing of liquidation preferences, we must not sanction the destruction of [fol. 16] that interest through the operation of the statutory mandate.[15a]

Clearly the intent of Congress was that the techniques employed under Section 11 should be those necessary to remove the holding-companies' concentration of economic power over operating utilities, promote local management and regulation for the benefit of consumers, eliminate unnecessary and uneconomic corporate entities, and benefit investors generally by giving them more direct interests in the operating properties and earnings *to the extent that their holding-company securities represent any real equity therein.*[16] The liquidation of Power accomplishes an im-

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[15a] This conclusion seems to us in no way inconsistent with the Commission's position as to the right of bondholders to a premium on liquidation, nor with the implications of the various cases arising under the Anti-Trust Acts which are referred to in the dissenting opinion. Interpretation of contract provisions is of course a necessary starting point for evaluating interests. There remains the question of what may be fair and equitable in the light of the entire bundle of contractual rights.

[16] That this process was not to operate so as to destroy values was emphasized repeatedly. For example, in reviewing the integration and simplification provisons of the Senate bill, the report of the Committee on Interstate Commerce points out that one means of compliance would be for holding companies: "to distribute their securities and assets equitably among their security holders. Precedents under the Sherman Antitrust Act and under the Hepburn Act demonstrate that the necessary corporate adjustments can be made without forced liquidation or the sacrifice of legitimate investments values." Sen. Rep. No. 621 (74th Cong. 1st Sess.) at p. 33. It is clear from the context that

portant step in this direction by giving the preferred and common stockholders a security that is better than those they have heretofore held. This process of improvement of position must not be permitted to destory any legitimate interests of the common stock, or present a windfall to any [fol. 17] senior security. Where such an inequitable result would be reached by borrowing bankruptcy techniques for assessing the claims involved, we must reject bankruptcy techniques as inappropriate under the circumstances; and we think it logical enough that they should be inappropriate here, since the situation before us is (as we have seen) not comparable to the situation found in bankruptcy.[17]

"forced liquidation" as used by the Committee meant forced sales.

Congressman Eicher (later Chairman of this Commission and now Chief Justice of the District Court of the United States for the District of Columbia), discussing the same bill (S. 2796), expressed his views and the views of other members of the House Committee in these terms:

> "But Section 11 of the Senate bill would give fair assurance that what is left of the investor's equity would not hereafter be taken from him and it would give fair assurance that any legitimate increase in value of the underlying properties would go to investors * * *
>
> "There is nothing in Section 11 of the Senate bill which will hurt any legitimate investment interest. It does strike and strike hard at that dangerous concentration of economic power which resides in the holding company." H. Rep. No. 1318 (74th Cong. 1st Sess.) at p. 51.

In so far as pertinent to this question, the purposes of Section 11 in the final enactment coincided with those of the Senate Bill. See H. Rep. No. 1903 (74th Cong. 1st Sess.) at pp. 65, 68-71.

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[17] Indeed, the legislative history of the Act appears to recognize the inapplicability of precedents in bankruptcy. See the statement of the Senate Committee, footnote 16 *supra*.

Earlier in the same report the Committee spoke of the courts exercising "all the extraordinary powers such courts

It is pointed out in Commissioner Healy's separate opinion that the words "fair and equitable" embodied in Section 11 have a settled meaning, as determined by the courts, and that an application of the "absolute priorities" doctrine must result in no distribution to Power's common stock in this case. But that is because he measures the rights of the preferred stock as they would be measured in bankruptcy cases, and not merely because he follows the "absolute priorities" doctrine in determining the consequences of the measurement. In other words, we can agree with him when he says that absolute priorities must be respected, because we think that doctrine simply means that the common stock must not be accorded any participation unless the preferred stock has been fully compensated for its rights and priorities. But there the area of agreement stops, because he says further that the rights and [fol. 18] priorities of the preferred stockholders are the same here as in bankruptcy cases, where their claims to liquidation preferences (including dividend arrearages) are treated as matured. In our view it would be unconscionable and contrary to the plain intention of Congress to so hold.

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have been accustomed to exercise when called upon under the Sherman and Hepburn Acts to effect compulsory corporate readjustments required by the public policy expressed in those acts." Id., at p. 13.

And further:

> "* * * The process of compulsory divestment of control is left to the Federal courts, without time limit, for the applications of the technique worked out in the dissolution under the Sherman Act and the Hepburn Act (commodities clause).
>
> "The title provides that during all court processes the Securities and Exchange Commission shall act as an impartial expert economic adviser and administrative assistant to the courts. That expert assistance will enable the courts to save time and expense in the solution of essentially economic and administrative problems for which in the Sherman Act cases it had no assistance except that of opposing counsel. But the courts can take such time as they deem advisable to dispose of assets without sacrifice." Id., at p. 14.

It is our conclusion that we must judge the fairness of the plan according to legitimate investment values existing apart from the duty of liquidation imposed by the statute. The existence of the liquidation preference does, of course, enter into the question as it is one of the bundle of rights belonging to the preferred stock and affecting its normal value. The preference itself, however, will not be permitted to operate so as to be conclusive in the division of assets between the preferred and common stocks.[18]

By the foregoing we do not imply that compensation should or can be given in eliminating any "rights" which are proscribed by the statute as being unfair, such as the naked "right" to exercise a voting power which is inequitable under the statutory standards or the "right," by misuse of power, to delay or prevent compliance with the statute. The "legitimate investment value" to be accorded recognition may include those rights and expectancies which, although possibly predicated on an unsound or economically undesirable structure, are not inherently unfair. An example is the interest of the common stock in net income over and above fixed amounts applicable to senior securities—where there is a reasonable chance of such income. Although it is repugnant to the policies of the Act to have the corporation continue in operation, the common stockholders' interest in the earnings of Power's assets is not for that reason proscribed. The limitation of the preferred stock dividend to a fixed amount, [fol. 19] is a valuable right vested in the common stock; and the value of such right, in light of the earning capacity of Power's assets, may be recognizable even though it would take a number of years, in the absence of liquidation, for dividends to be payable to the common stock. The accumu-

[18] This is the first instance in which we have been called upon to decide this precise question. To the extent that our conclusion is at variance with *dicta* in previous cases, such *dicta* are overruled.

For example in *Federal Water Service Corp., et al.*, 8 S. E. C. 893 (1941), we intimated that in a liquidation required under Section 11 (b) (2) the rules applicable to a bankruptcy reorganization proceeding would be applicable (p. 910). That case did not involve liquidation of any kind, and the language referred to was not necessary to the decision.

lation of preferred dividend arrearages does not constitute a matured claim in the absence of liquidation, and does not require compensation to the preferred stockholder for the lapse of time which may precede payment.

To accelerate the arrearages and translate them into matured claims at their full face amount, so as to entitle the preferred stock not only to all the assets but also in perpetuity to the entire earning power of those assets—a portion of which would otherwise have been applicable to the common stock—would clearly be to enrich the preferred at the expense of the common.

Under the circumstances, fair and equitable compensation will be given to all of the claimants if their rights are measured not in terms of the situation created by the statute but rather in terms of the situation terminated by it—i. e., as though no liquidation were to take place. In this way each class of stock will be accorded its proportionate share of the benefits to be gained from the elimination of a useless and expensive corporate entity and from the receipt of a security representing a more direct investment in the underlying assets and earnings of the system.

In approaching the problem of passing upon the fairness of the proposed plan in the light of the principles discussed, it is our view that it is unnecessary to arrive at any specific over-all value for the enterprise or for the preferred and common stocks of Power. We are required, however, to examine into the respective existing interests of the preferred and common stockholders in the earnings of the enterprise. The valuation of interests such as these is not an exact science, even in the most favorable circumstances. Presented with a proposed allocation of assets such as that suggested here, the best we can do is to deter- [fol. 20] mine what assumptions are necessary to arrive at the allocation, and ascertain whether such assumptions fall within the permissible limits of reasonableness.

The following tabulation sets forth the corporate and consolidated net income per books applicable to the preferred and common stock of Power, the preferred dividend requirements and the balance of consolidated net income applicable to Power's common stock, for the period from 1929 [19] through 1942.

[19] The presently outstanding 660,000 shares of preferred stock were issued during 1929 and 1930.

[fols. 21-22]

Years Ended December 31	System Net Income Before Power's Preferred Dividend Requirements		Power's Preferred Dividend Requirements	Consolidated Balance (Deficiency) Applicable to Common Stock of Power
	Corporate	Consolidated		
1929	$2,663,602	$9,971,641	$2,469,505 (a)	$7,502,136 (b)
1930	6,212,264	10,462,450	3,568,613 (a)	6,893,837 (b)
1931	6,956,991	7,819,382	3,600,000 (a)	4,219,382 (b)
1932	4,582,947	4,171,925	3,600,000 (c)	571,925
1933	1,233,591	1,510,925	3,600,000	(2,089,075)
1934	663,188	986,719	3,600,000	(2,613,281)
1935	311,268	2,411,652	3,600,000	(1,188,348)
1936	121,851	4,508,261	3,600,000	908,261
1937	402,139	5,182,602	3,600,000	1,582,602
1938	627,594	3,091,508	3,600,000	(508,492)
1939	2,342,432	4,598,654	3,600,000	998,654
1940	2,365,832	5,266,602	3,600,000	1,666,602
1941	930,813	4,134,544	3,600,000	534,544
Total of 13 yrs.	$29,414,512	$64,116,865	$45,638,118	$18,478,747 (e)
1942 Estimated	1,200,000	6,700,000 (d)	3,600,000	3,100,000
	$30,614,512	$70,816,865	$49,238,118	$21,578,747

a Preferred dividend paid during these years.
b During these years the following common stock dividends were paid:

1929	$1,841,937
1930	3,441,262
1931	3,469,597

None thereafter.

c $900,000 or one-fourth of the annual requirements was paid in 1932.
d Before provision for $160,000 fixed charges on Power's debentures paid on May 1, 1942.
e In contrast, the consolidated surplus at December 31, 1941 was zero. The reduction has resulted from the provision for and the elimination of losses during past years.

[fol. 23] Power's corporate income, as shown in the table, has never equalled the annual preferred requirements since 1932. Consolidated earnings for the period 1929 through 1942, however, as may be noted, present a different picture, showing a net balance applicable to the common stock. It will be seen that indicated undistributed consolidated earnings for the fourteen-year period amounted to $51,525,951 of which $38,700,000 is applicable to Power's preferred stock and the balance of $12,825 951 is applicable to Power's common stock.

Power has urged that consolidated earnings rather than corporate earnings should be considered of paramount importance in estimating the potential earning power of the system. A number of factors are cited in the record in support of the soundness of consolidated earnings, including the relative absence of inflationary items in the system companies' property accounts, the moderate amount of

preferred stocks in the operating companies and their freedom from dividend arrearages, the fact that the flow of current earnings is not impeded by the existence of restrictions on the earned surplus accounts of the underlying companies and the relative adequacy of depreciation reserves and current annual provision for depreciation and maintenance compared to the average for the industry.[20] While the company has urged the soundness of consolidated earnings it has pointed out that considerations of tax lia- [fol. 24] bility and good management made it inadvisable in the past to pay up the major portion of consolidated earnings to Railways and Power.[21] At the same time the

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[20] Annual provision for depreciation and retirements by each of the 9 major public utility subsidiaries for the year ended April 30, 1942, ranged from a low of 5.9% of gross revenues to a high of 12.3%, the average being 8.9%. In terms of gross plant and property the provision for depreciation and the retirements ranged from 1.54% to 3.27% for an overall average of 2.33%. The record shows that the depreciation rates applied by the system companies are substantially in line with those approved for federal income tax purposes. The combined provisions for maintenance, depreciation and retirements for the year ranged from a low of 9.5% of gross revenues to a high of 18.9% for an average of 13.6% for the 10 companies.

The record indicates that the ratio of depreciation reserve to plant and property as of April 30, 1942 ranged from a low of 13.6% to a high of 26.2%, the average for the 9 major public utility subsidiaries being approximately 20.5%. In comparison, the average ratio for 210 electric and gas subsidiaries of registered public utility holding companies as of December 31, 1941, was 13.64%.

Nothing in this opinion shall be construed as a finding with respect to the adequacy or inadequacy of reserves for depreciation or of annual provisions for depreciation and maintenance.

[21] The record shows that earnings have been largely retained to be applied to protect and strengthen the equity of Railways' common stock of Power's preferred and common stock. During the 10-year period from 1932 through 1941 the system has had undistributed consolidated net income amounting to $33,237,000 and has realized cash from

management has expressed the view that the system will be able, in the future, to draw up from its subsidiaries a larger percentage of their earnings than in the past. Further simplification of the obviously top-heavy superstructure of the system, now in progress, may be expected to provide substantial aid in facilitating this upward flow of dividends. The management, however, has made no precise statement as to when, or in what amounts, it can be expected that dividends will be paid on Railways' new common stock.

It will be seen that the consolidated earnings have fluctuated widely over the 14-year period covered by the table. It should also be noted that the consolidated earnings reported for the years 1929, 1930 and 1931 are of questionable usefulness as an index of earning power due to the inclusion therein of items such as profits from dealing in the system's own securities and income from call loans.

Consolidated earnings during the ten years from 1932 through 1941 approximately equalled the preferred dividend requirements. The management disputes the propriety of using the results of this period, however, as a fair measure of the system's potential earning power under normal conditions. In support of its contention there have been cited the adverse effects of the depression in the earlier years of this period, the unusual expense incidental to the substitution of natural for manufactured gas, the [fols. 25-26] cost of retiring railway transportation facilities replaced by bus service, and the reduction of fixed charges and preferred dividend requirements resulting from the relatively recent use of system earnings in substantial amounts to retire debt and preferred stocks senior to the preferred and common stock of Power and the common stock of Railways. The management argues that earnings subsequent to 1936 constitute a more reliable

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the sale of assets ($36,260,000), from depreciation accruals ($83,595,000) and from amortization charges ($8,694,000). Of the aggregate of these amounts ($161,786,000), $157,684,000 has been used as follows: $108,562,000 for property additions; $19,414,000 for long-term debt reductions; $4,667,000 for preferred stock reduction; $4,780,000 for reduction of minority interests in system companies and $20,261,000 to increase net current assets.

measure of prospective earning power than either earnings for the 13-year or the 10-year period prior to 1942.

In considering the earnings subsequent to 1936 the management has contended that adjustments should be made to reflect the earnings of the system as constituted at a relatively recent date and to restore certain "non-recurring" expenses charged to earnings during the period. Effect is given to these contentions in the following table of earnings for the system as of April 30, 1942, the most recent practicable date for which financial information could be supplied at the time the plan was filed.[22] The table also includes a statement of earnings for 1942 based on 9 months' actual and 3 months' estimated operations.

[fols. 27-28]

The United Light and Railways Company
Comparative Consolidated Net Income Applicable to
Railways' Common Stock for the Years 1937 through 1942

Period	Consolidated Net Income of Power Before Power's Preferred Dividend Requirements	Amount Applicable to Common Stock of Railways Adjusted for System as Constituted at April 30, 1942	Adjustments* for Non-recurring Expenditures Netted for Income Taxes	Adjusted Consolidated Balance Applicable to Common Stock of Railways
1937	$ 5,182,602	$ 5,856,311	$ 556,643	$ 6,412,954
1938	3,091,508	3,962,314	749,095	4,711,409
1939	4,598,654	5,118,375	922,575	6,040,950
1940	5,266,602	5,772,567	1,091,483	6,864,050
1941	4,134,544	4,906,879	1,064,738	5,971,617
Total of 5 years	$22,273,910	$25,616,446	$4,384,534	$30,000,980
1942 (9 mos. actual; 3 mos. est.)		6,874,277	232,012	7,106,289
Total of 6 years		$32,490,723	$4,616,546	$37,107,269
5 year average (1937-1941, incl.)		$ 5,123,289	$ 876,906	$ 6,000,196
6 year average (1937-1942, incl.)		5,415,120	769,425	6,184,545

*These include adjustments for non-recurring expenditures urged by the management as necessary to a determination of the normal earning power of the

[22] It should be understood that the consolidated adjusted earnings applicable to the common stock of Railways, as shown in the table, are substantially equivalent to those which would be applicable to the preferred and common stock of Power since upon consummation of the plan, involving the contribution of all assets of Power (other than Railways' common stock) to Railways, the earning power of Railways will be identical with that of Power.

[fol. 29] As shown in the table consolidated earnings applicable to the common stock of Railways, adjusted as suggested by the management, averaged $6,000,196 for the 5-year period 1937-41, inclusive, and $6,184,545 for the 6-year period 1937-42, inclusive. To reach these amounts, adjustments must be made, as noted in the table, for "non-recurring" expenses in substantial amounts. While there is serious doubt as to the propriety of adding back a number of these items, probably some recognition must be accorded to the benefits inuring to the system as a result of these expenditures. In addition, there may be a question as to the weight to be given to reported earnings to the extent that they reflect savings in taxes deriving from losses to the system during these years; to the extent that normal tax liability was materially minimized through losses of a "non-recurring" nature, the earnings would be correspondingly overstated.

With respect to future earnings prospects, Harry B. Munsell, Vice-President of Power, testified at the hearings that in the opinion of the management the earning power of the system under normal conditions would provide an annual consolidated net income of between $6,500,000 and $7,000,000 which would be applicable to Railways' common stock and hence to the preferred and common stocks of Power. This estimate of prospective income appears optimistic, being higher than any in the last ten years, and very materially in excess of the average for that period. While consolidated earnings in 1942 support the manage-

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system. The charges in question fall generally into two classifications, i. e., (1) expenditures of an unusual nature which should not ordinarily be repeated and (2) charges for amortization which do not represent current cash expenditures or depreciation of properties. In the former category are charges of substantial amounts representing expenses in connection with certain appraisal and rate case matters before regulatory commissions. Although it cannot be predicted that such cases will not arise in the future, the management points out that the substantial amounts already spent and the progress made in reclassifying the property accounts in all the system companies on an original cost basis, together with the fact that continuing property inventory records are kept by the system companies, militate against the recurrence of expenditures of this sort in any large amounts. Illustrative of charges in the latter category are those for amortization of plant acquisition adjustments and for amortization of street railway property abandonments. The management urges that while charges of this type, when made, constitute bookkeeping deductions against income available for dividends, the application of cash generated pursuant to such amortization programs results in no decrease in asset value, but rather improves the quality of the investment of security holders by transposing intangible items into tangible ones and enhances earnings. In connection with non-recurring credits to income, the management represents that no such credits of any important magnitude are included in the record of earnings set forth above, it having been the practice of the system to credit any important non-recurring credits directly to earned surplus rather than to earnings.

ment's estimates, it should be borne in mind that the comparable actual figure in 1941 was $4,906,879. The increase in consolidated earnings to approximately $6,800,000 in 1942 resulted principally from income and excess profits tax savings made possible under the Revenue Act of 1942 which permits the filing of consolidated income tax returns for normal and surtax purposes as well as for excess profits tax purposes.

Thus, any judgment as to the reasonableness of earnings approximating those in 1942 as a measure of prospective [fol. 30] income must be made in the light of both a comparison with recent earnings and the savings in 1942 to be derived from filing consolidated income tax returns, considering at the same time the possibility that these savings may be affected in the future by either a change in the tax law or in the security structure of the system. In addition, it should be pointed out that the earnings of some of the underlying subsidiaries may be high in relation to the depreciated cost of properties.

For the purpose of determining the existing rights of the preferred and common stocks in the enterprise, we have assumed earnings of $6,185,000, the average adjusted consolidated income applicable to Railways' common stock for the period 1937-42. However, it must be pointed out that in view of the actual earnings experience and the intangible factors discussed, this figure must be regarded as a very liberal assumption as to earning power.

As of December 31, 1942, the dividend arrearages on the preferred stock totalled $38,700,000. Current annual dividend requirements on such stock amount to $3,600,000. On the basis of the $6,185,000 earnings figure, it would take approximately 15 years for the preferred dividend arrearages to be paid in full, if all consolidated net earnings were to be applied toward the payment of current and accumulated preferred dividends.

Under the assumptions we have stated, it is recognized that at best the interest of the common stock in earnings is remote. Particularly is this true since, as a practical matter, all consolidated earnings would not be available for disbursement to the preferred and common stockholders. The remoteness of the common stock's participation is also demonstrated by the fact that actual earnings have fluctuated substantially and have never in the past ten years exceeded the figure we are assuming, except in 1942. Furth-

ermore, as already noted, we are unable to accept at full value the adjustments to past earnings submitted by the management in support of the allocation provided for in the plan. In view of all these considerations and of all other [fol. 31] factors appearing in the record, we are unable to find that a participation for the common stock as high as the proposed 8.8% falls within the permissible limits of reasonableness for a situation of this kind. We must, therefore, withhold our approval of the plan.

While we have reached the conclusion that the allocation provided for in the plan is too liberal to the common stock, our consideration of all the circumstances leads us to believe that the common stock is nevertheless entitled to some participation. Our conclusion in this respect is of necessity one of over-all judgment and not susceptible of mathematical demonstration. In approaching the problem, we have kept in mind that there is always a margin of error inherent in any estimate of earning power. Under all the circumstances it is our view that a participation for the common of approximately 5%, while representing the maximum, would not exceed the permissible limits of fairness, and to secure our approval the plan must be modified to reduce the common stockholders' participation accordingly.

This conclusion takes into consideration the fact that, to the extent its earnings should perchance exceed those estimated, the common stock, in exchange for an allocation of approximately 5% would be giving up its claim to 95% of any possible excess over the amount necessary to satisfy the dividend preferences of the preferred. In other words, as the participation of the common stock approaches zero it is giving up, in exchange therefor and for the benefit of the preferred stock, nearly 100% of its chance of participating in any future earnings in excess of the existing preferences of the preferred. On the other hand, if earnings do not equal such preferences, the preferred stock gives up but approximately 5% of the earnings actually realized.[23]

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[23] In considering the possible margin of error inherent in any attempt to forecast future earnings, allowance must be made for the fact that we are dealing with a top company in a pyramided structure. As a result of "leverage" any fluctuations in underlying earnings are greatly magnified in their import upon earnings available for securities of the top holding company.

[fol. 32] Under the circumstances here present, we are unwilling to permit the complete elimination of the common stock. Our conclusion in this regard is reinforced by reason of our belief that the whole future program of corporate simplification and geographic integration of the system, as in the case of the present step in such program, will result in an improvement of the investment position of both the preferred and common stock. That improvement, we believe, should be shared by the common as well as by the preferred, and the process of securing such improvement in compliance with the Act should not be permitted to destroy existing investment values.

We have earlier stated our view that the plan is necessary to effecuate the provisions of Section 11 (b). This finding was, of course, based on the assumption that the plan would be found to be fair and equitable or would be modified so as to meet such requirement. While the plan accomplishes the liquidation and dissolution of Power required by our order under Section 11 (b) (2) of the Act, it makes no attempt to effect a redistribution of voting power in so far as Railway's preferred stock is concerned. This matter will be the subject of consideration at an appropriate time in the pending proceedings under Section 11 (b) (2) of the Act.

As earlier noted, the proposed plan makes no provision for submission to security holders for approval, but the applicants have requested that, upon approval by the Commission, we apply to an appropriate Federal Court to enforce and carry out the terms and provisions of the plan as approved. Under these circumstances we are of the opinion that approval of security holders is not necessary. In order to keep the security holders fully informed and particularly to advise them of the modification in allocation required in order to secure our approval, we shall, by condition to our order approving the plan, if modified as proposed, require Power to make a copy of this opinion available to each of its security holders.

[fol. 33] Our order approving the modified plan shall provide that upon its acquisition of the securities of Clear Lake and of La Porte, if the securities of the latter company are acquired, Railways shall be bound to the same extent as Power, by the prior orders of this Commission directing Power to divest itself of its interest in said companies.

Compliance with Other Provisions of the Act

Prior to granting final approval of the plan as modified, we must find that the individual transactions comprising the plan comply with all other applicable sections of the Act.

As we have noted, the plan contemplates the transfer of the investments in La Porte and Clear Lake from Power to Railways pending their disposition in accordance with our earlier orders. We grant our approval of these transfers under Section 12 of the Act, and the rules promulgated thereunder, and we find that these acquisitions by Railways meet the standards of Section 10. Since these properties are to be retained only temporarily and are to be acquired in conjunction with corporate simplification to be attained through the elimination of Power, the top holding company, we believe that the proposed acquisitions will serve the public interest by tending towards the economical and efficient development of an integrated public-utility system as required by Section 10 (c) (2).

The standards of Sections 6 and 7 are applicable to the new common stock to be issued by Railways in exchange for its presently outstanding common stock. This stock meets the requirements of Section 7 (c) and, having in mind our continuing jurisdiction to examine the corporate structure of the system and to order necessary action under Section 11 (b) (2), no adverse findings are required under Section 7 (d). Also we approve Railways' acquisition and retirement of its present common stock, pursuant to Section 12 (c) of the Act.

[fol. 34] The equity contribution by Power to Railways, consisting of the investments in La Porte and Clear Lake and the excess of current assets to be transferred over liabilities to be assumed, has our approval under Section 12 (b) and Rule U-45. Furthermore, the accounting entries necessitated by the various transactions comprising the plan are approved under the applicable sections of the Act and the Rules thereunder.

Pending final determination of the amounts upon consummation of the plan and completion of the record with regard thereto, we shall reserve jurisdiction to pass upon the reasonableness of all counsel fees.

Conclusion

For the reasons appearing hereinabove, we have concluded that we can approve the plan with the modification as to participation we have noted in this opinion, subject, however, to the several conditions and reservations of jurisdiction indicated. If the company desires to adopt this modification and to request us to apply to a court to enforce and carry out the terms and provisions of the plan, as modified, we will proceed immediately to comply with such request.

By the Commission (Chairman Purcell and Commissioners Pike, Burke and O'Brien), Commissioner Burke filing a separate statement of additional views, and Commissioner Healy filing a dissenting opinion.

Orval L. DuBois, Secretary. (Seal.)

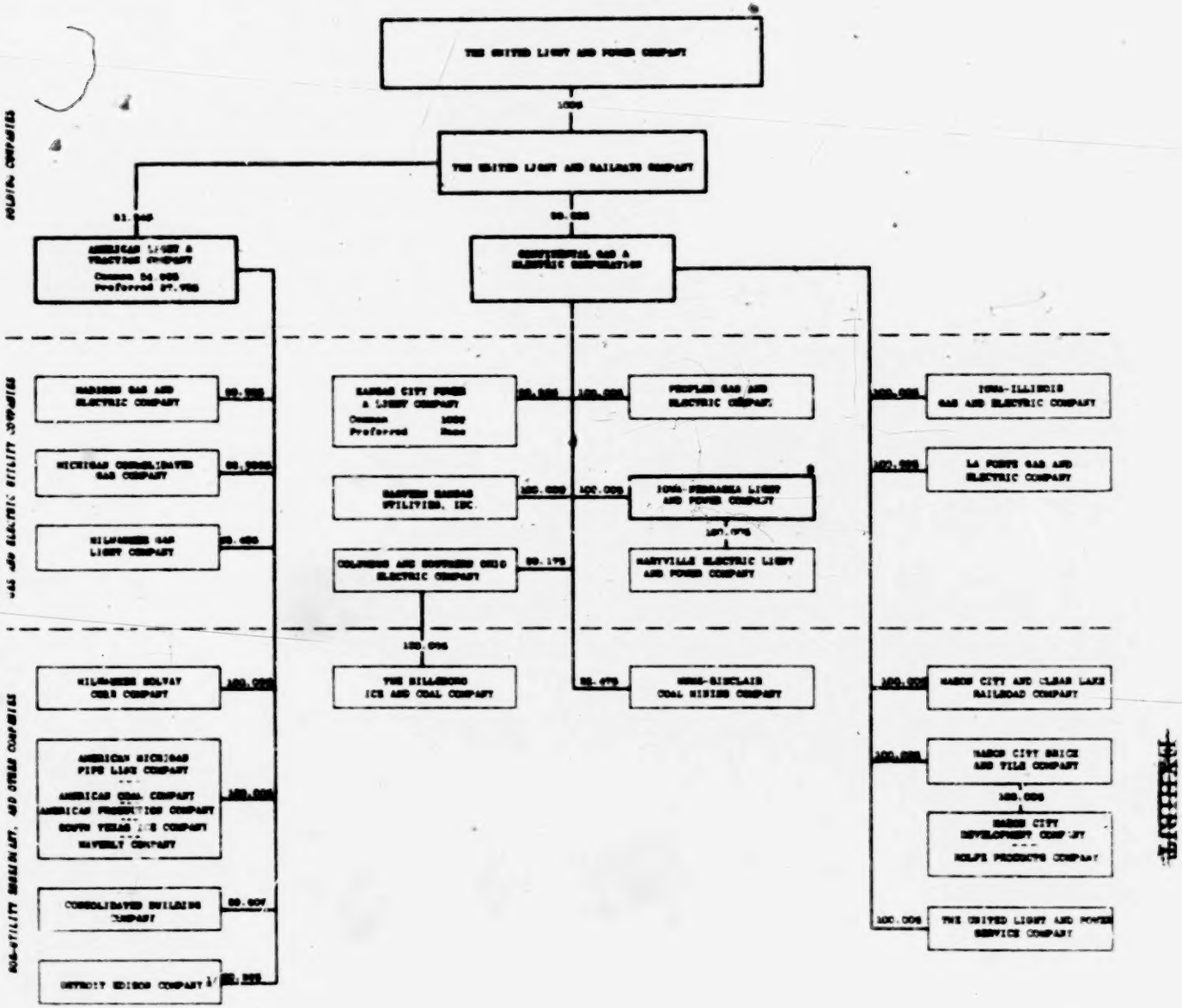
April 1, 1943

(Here follows 1 photolithograph, folio 35-36.)

EXHIBIT A

PRO-FORMA CORPORATE CHART OF POWER AND ALL SUBSIDIARIES
THEREOF SHOWING THE PERCENTAGE OF EACH CLASS OF VOTING
SECURITIES OF EACH SUBSIDIARY HELD BY POWER AND EACH
SUBSIDIARY AND THEREOF

Date: November 1, 1968



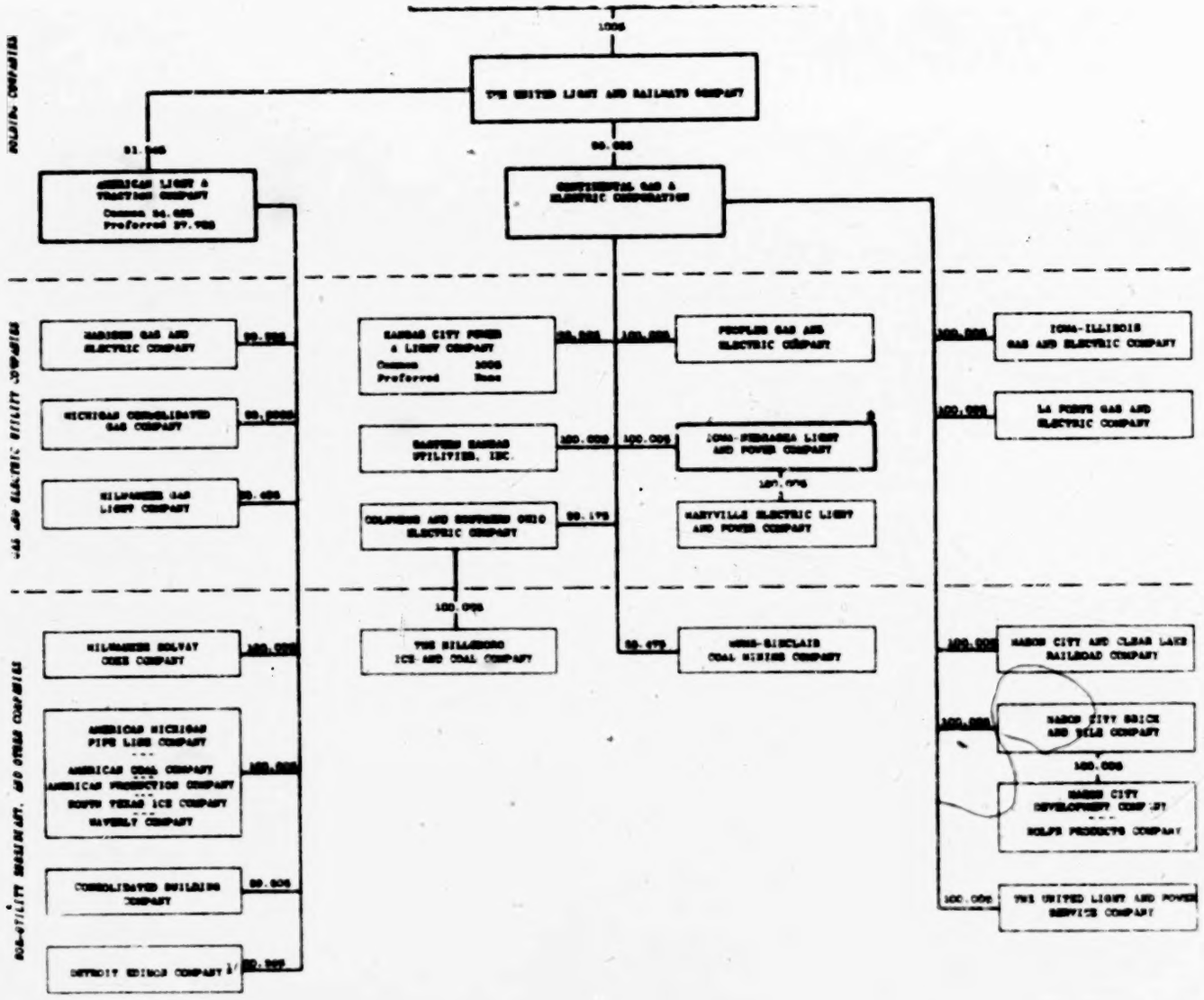


EXHIBIT E

* IOWA-NEBRASKA LIGHT AND POWER COMPANY IS ALSO A HOLDING COMPANY.

NOTE: THE FIGURE SET FORTH IMMEDIATELY ABOVE THE NAME OF EACH SUBSIDIARY COMPANY INDICATES THE PERCENTAGE OF THE TOTAL VOTING POWER CONSTITUTED BY THE SECURITIES OF THE SUBSIDIARY OWNED BY THE DESIGNATED HOLDER OF THE SECURITIES OF THE SUBSIDIARY. IN CLASS WHERE LESS THAN ALL THE VOTING SECURITIES ARE OWNED BY THE DESIGNATED HOLDER AND THE VOTING SECURITIES CONSIST OF MORE THAN ONE CLASS OF SECURITIES, THE PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED BY THE DESIGNATED HOLDER IS SET FORTH WITHIN THE RECTANGLE DESIGNATING THE SUBSIDIARY.

1/ EXEMPT AS SUBSIDIARY BY ORDER OF COMMISSION OF AUGUST 8, 1945.

[fols. 37-38]

EXHIBIT B

The United Light and Railways Company—Actual and Pro Forma Corporate Balance Sheets—With Details of Transactions—April 30, 1942

	Per Books	Contribution of Investment in Clear Lake by Power	Contribution of Remaining Assets by Power	Exchange of Common Stock of Railways	Pro Forma
Assets					
Investments in subsidiaries *b*	$115,747,799	$150,000	—	—	$115,897,799
Other investments	1,372,958	—	—	—	1,372,959
Deferred charges	466,012	—	$60,841	—	526,853
Special deposit in escrow of redemption premium of debentures of Power	—	—	1,358,442	—	1,358,442
Current Assets (cash $2,399,277)	2,321,940	—	433,918	—	2,755,857
Pro Forma					
Total	$119,908,709	$150,000	$1,853,201	—	$121,911,910
Liabilities					
5½% Debentures due 1952	$23,837,000	—	—	—	$23,837,000
7% prior preferred stock, cum.	3,799,300	—	—	—	3,799,309
6.36% prior preferred, cum.	5,232,900	—	—	—	5,232,000
6% prior preferred, cum.	9,951,600	—	—	—	9,951,600
Common stock	24,798,200	—	—	($1,112,138)*c*	23,686,062
Current Liabilities *b*	1,136,236	—	—	—	1,136,236
Paid-in Surplus *d*	47,608,905	$150,000	$1,853,201	1,112,138	50,724,244
Earned Surplus *d*	3,544,568	—	—	—	3,544,568
Total	$119,908,709	$150,000	$1,853,201	$	$121,911,910

a The pro forma balance sheet reflects consummation of the plan in its original form with the issuance of 3,947,677 shares of new $6 par value common stock of Railways.

b The pro forma investment account and current liabilities would be increased by $1,500,000 in the event the sale of La Porte is not consummated before the effective date of the Plan.

Shares		Par Value Per Share	Total
Present	708,520	$35	$24,798,200
Pro Forma	3,947,677	6	23,686,062
		Reduction in common stock	$1,112,138

d See Notes c and d to the consolidated balance sheet (Exhibit C).

[fol. 39] EXHIBIT C

The United Light and Railways Company and Subsidiaries

Actual and Pro Forma Consolidated Balance Sheet—April 30, 1942

Assets	Actual	Pro Forma [a]
Utility Plant (including intangibles)		
Combined property accounts of operating subsidiaries	$391,372,776 [b]	$391,372,776 [b]
Excess of carrying value of investments in securities of subsidiaries over underlying book value at dates of acquisition	38,441,561	38,441,561
	$429,814,337	$429,814,337
Investments		
The Detroit Edison Company	$ 47,361,886	$ 47,361,886
International Paper Company	3,938,091	3,938,091
Miscellaneous (less reserve for loss on miscellaneous investments of $182,250)	4,062,824	4,212,824
	$ 55,362,801	$ 55,512,801
Deferred Charges	$ 21,279,298	$ 21,340,139

[a] Giving effect to the acquisition from Power of assets aggregating $2,003,200, credited to paid-in surplus, the reduction of $1,112,138 in the par value of common stock, also credited to paid-in surplus, and the issuance of 3,947,677 shares of new $6 par value common stock of Railways.

[b] At April 30, 1942 there was included in Utility Plant Account an aggregate of approximately $17,500,000 in Accounts 100.5 and 107. At December 31, 1942, after adjustments by Kansas City in accordance with orders of

Special Deposit in Escrow of redemption premium in connection with payments of debentures of The United Light and Power Company	—	1,358,442
Current Assets	52,351,127	52,785,045
	$558,807,563	$560,810,764
[fol. 40] Liabilities		
Capital Stock of the United Light and Railways Company		
Preferred	$ 18,983,800	$ 18,983,800
Common	24,798,200	23,686,062
	$ 43,782,000	$ 42,669,862

the Federal Power Commission, there remained approximately $14,300,000 in these accounts; $8,500,000 in 100.5 and $5,800,000 in 107. After excluding the portion applicable to minority interests, there is applicable to Railways' common stock approximately $7,360,000 in Account 100.5 and approximately $4,060,000 in Account 107.

Four of the system companies are presently involved in proceedings before Federal or State regulatory authorities to determine the appropriate disposition of the amounts included in these accounts. Applicants estimate that these proceedings will dispose of over 85% of the aggregate amount included in Account 107 and approximately 30% of the aggregate amount included in Account 100.5. The major remaining item in Account 100.5 in the amount of approximately $5,000,000 or 60% of the system aggregate, relates to Columbus and Southern Ohio Electric Company. This company is subject to the jurisdiction of the state utility commission of Ohio but not of the Federal Power Commission. It has not as yet been required to file a study with respect to the original cost of its property nor any plan for the disposition of the amount included in Account 100.5.

Capital Stock of Subsidiaries and Surplus Applicable to Common Stock Held by Public		
Preferred	$ 45,860,693	$ 45,860,693
Common	31,658,002	31,658,002
Paid-in Surplus Applicable to common stock[c]	8,457,991	8,457,991
Surplus applicable to common stock[c]	13,557,353	13,557,353
	$ 99,534,039	$ 99,534,039
Long-Term Debt		
The United Light and Railways Company	$ 23,837,000	$ 23,837,000
Subsidiaries	207,823,500	207,823,500
	$231,660,500	$231,660,500
Due to Affiliated Companies	8,884	8,884
Current Liabilities	33,059,094	33,059,094
Premium on Long-Term Debt, less expenses, in process of amortization over lines of related issues	4,798,508	4,798,508

[c] The validity of the aggregate amount in the two surplus accounts is subject to such adjustments as may be necessary to evaluate properly the following items: (a) excess of carrying value of investments in securities of subsidiaries over underlying book value at date of acquisition in the amount of $38,441,561; (b) amounts classified as Account 107 in the amount of $8,979,909 and Account 100.5 in the amount of $8,614,101; and (c) the excess of the carrying value of the investments in Detroit Edison and International Paper Company over the company's estimate of the value thereof, which value is approximately $15,000,000 less than the amount presently recorded on the books.

[fol. 41]

Reserves		
Depreciation	$ 85,525,628	$ 85,525,628
Other	3,195,614	3,195,614
	$ 88,721,242	$ 88,721,242
Contributions in Aid of Construction	$ 2,490,367	$ 2,490,367
Paid-in Surplus [c]	47,608,905 [d]	50,724,244 [d]
Surplus—Applicable to the United Light and Railway Company [c]	7,144,024	7,144,024
	$558,807,563	$560,810,764

[fol. 42] BURKE, C., concurring:

I agree with all that is said in the principal opinion. I desire merely to point out that, for my part, the rejection of the proposed allocation of 8.8% of the common stock of Railways to the holders of the common stock of Power need not be rested solely upon an over-all judgment.

As stated in the principal opinion, the valuation of interests such as these is not an exact science, even in the most favorable circumstances. Presented with a proposed

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[c] The validity of the aggregate amount in the two surplus accounts is subject to such adjustments as may be necessary to evaluate properly the following items: (a) excess of carrying value of investments in securities of subsidiaries over underlying book value at date of acquisition in the amount of $38,441,561; (b) amounts classified as Account 107 in the amount of $8,979,909 and Account 100.5 in the amount of $8,614,101; and (c) the excess of the carrying value of the investments in Detroit Edison and International Paper Company over the company's estimate of the value thereof, which value is approximately $15,000,000 less than the amount presently recorded on the books.

[d] Of this amount $46,053,800 arose from the reduction in 1932 of the par value of common stock from $100 to $35 per share.

allocation of assets such as that suggested here, the best we can do is to determine what assumptions are necessary to arrive at the allocation, and ascertain whether such assumptions fall within the permissible limits of reasonableness. It is obviously impossible to estimate future earnings or determine the proper basis of appraisal of interests therein with sufficient exactness to arrive at a precise mathematical allocation. But the mere fact that a particular method of appraisal lacks the degree of precision which might be desired does not justify rejecting its use where that degree of precision is not called for. It is possible to determine, in the light of various possible assumptions as to earnings and as to the basis of appraisal of interests therein, whether the common stock is entitled to some recognition, and whether the proposed 8.8% allocation to the Power common stock falls within or without the permissible limits of reasonableness. An ordinary yardstick may be of little use in measuring sixty-fourths of an inch, but it is a convenient instrument where there are yards, or even inches, to be measured.

I turn then to a consideration of the reasonableness of the proposed allocation—91.2% to the preferred stock and 8.8% to the common stock of Power.

If Power's existing capital structure were retained, the preferred would have a claim on earnings, prior to that of the common stock, for its annual dividend requirements of $3,600,000. The balance of earnings, or so much thereof as [fol. 43] was available to the parent company for the payment of dividends, would be applicable first to the elimination of the $38,700,000 of preferred arrearages, and thereafter to the common stock. If net earnings of the system were to average $6,185,000, a figure which the principal opinion characterizes as "a very liberal assumption as to earning power", the arrearages could be paid off in approximately 15 years, if the entire amount of earnings were available to Power and were paid out in dividends. I start with liberal assumptions as to earnings since if 8.8% appears excessive under such assumptions, it clearly could not be justified if more conservative hypotheses were used.

A prior claim of $3,600,000 on consolidated net income of $6,185,000 is obviously to be valued on a different basis from the claim to the balance of such consolidated net income, to whomsoever the latter claim belongs. These facts

appear to me to furnish a possible basis for testing the fairness of the proposed allocation as between the preferred and common stockholders of Power, believing as the majority does that the amount of the liquidation preference of the preferred stock is not controlling, but that, as stated in the principal opinion, the proposed allocation is to be judged "according to the legitimate investment values existing apart from the duty of liquidation imposed by the statute."

If a rate as low as 5% were used in capitalizing the earnings applicable to the preferred's prior claim of $3,600,000 for current dividends, it would be necessary to apply a rate of 8.5% (equivalent to nearly 12 times earnings) to the remainder of the estimated earnings of $6,185,000 in order to arrive at an allocation to the Power common of as much as 8.8%.[1] Both of these rates are obviously much too low in a situation of this kind. If the capitalization rate applicable to the preferred's prior claim for current dividend [fol. 44] were increased above 5%, however, the 8.8% allocation could be arrived at only by narrowing the spread between the rates to a point clearly inappropriate here, where the requirements for current preferred dividends equal 58% of the net income. For example, if an 8% capitalization rate were used for the preferred cur-ent dividends, the rate for the balance would have to be 10%. It is clear that if an 8% rate were appropriate for the former, a rate substantially higher than 10% should be used for the residual earnings. I therefore conclude that the assumptions necessary to arrive at an allocation as large as that suggested in the plan are clearly unreasonable even if all doubts are resolved in favor of the common.

Since the only proposal now before us provides for an allocation of 8.8% of the common stock of Railways to the common stockholders of Power, our inquiry might well have been terminated at this point. However, in order that the management may be provided with some guidance in formulating an amendment to the plan, if they desire to do

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[1] The present value of the earnings applicable to the common stock after provision for the preferred arrearages would be arrived at by capitalizing them and then discounting the resulting value to present worth, thus giving effect to the fact that there would be no earnings applicable to the common until after the arrearages had been paid off.

so, I believe it is appropriate for us to consider the participation, if any, which we could approve for the common stock.

After a careful appraisal of the contingencies involved, I agree that the common does have a prospect of sharing in the future earnings of the enterprise and is therefore entitled to some participation.

An allocation of approximately the 5% suggested in the principal opinion would appear to be very generous, even on the basis of liberal assumptions as to earnings, if tested by the method just applied to the proposed allocation of 8.8%. However, the margin of error involved in calculation of this type assumes greater importance as the participation approaches the vanishing point, and intangible considerations become entitled to increased weight. It must be borne in mind that an appraisal of the earning power, under normal conditions, of the system as now constituted must necessarily result not in a single figure, but an esti- [fol. 45] mated range—a maximum and a minimum. Earnings actually realized in a particular year, and indeed the average earnings actually realized over a period of time, might well be above or below the mean between this maximum and minimum. *Earnings actually realized in a particular year, and indeed the average earnings realized over a period of time, might well be above or below the mean between this maximum and minimum.* Should earnings exceed the estimate the common would receive only a small part of the increase although in the absence of a recapitalization they would be entitled to all earnings in excess of current preferred dividends, after settlement of the arrears. On the other hand since the common is to receive only a small percentage of the entire equity, the extent to which the preferred would suffer thereby if the earnings fall below the estimate on which the allocation is made would be negligible.

On the basis of a 95%—5% split and projected earnings of $6,185,000, 95% of that amount or $5,875,750 would be allocable to the preferred in perpetuity, instead of the $3,600,000 dividends to which they would be limited, after settlement of the arrears, if the present capital structure were preserved. In addition, 95% of any excess over such projected earnings would go to the preferred stock.

Under these circumstances, as the participation of the common approaches zero, we are warranted in considering increasingly liberal assumption in favor of the possibility

that earnings may substantially exceed what may be characterized as "reasonably foreseeable." In other words, the possible (though unlikely) rather than the probable range of earnings may be taken into account for the purpose of allotting to the common stockholders a small participation—whereas allotment of a more substantial participation would necessitate a more conservative appraisal. In view of these considerations I am unable to say that an allocation around 5% would be unfair.

April 1, 1943.

[fol. 46] DISSENTING OPINION

HEALY, C., dissenting:

This plan provides for the liquidation of Power through the disposition of its assets and its subsequent dissolution. It is filed under Section 11 (e) of the Act. It is not to be submitted to the stockholders. If approved by us, we are to apply to a court to enforce it, i. e., to impose it on the stockholders. Under 11 (e) we cannot approve the plan unless we find it necessary to effectuate the purpose of 11 (b) of the Act and fair and equitable to the persons affected by it.

I

Is the plan fair and equitable to the persons affected by it? Among those affected by it are the preferred stockholders. I think the plan is unfair and inequitable as to them. Whether it is fair and equitable as to them depends on their contract rights. These are found in the corporation's charter, which provides—

> "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the Class A Preferred stock shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of such stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned), including the full dividend for the then current quarterly period, before any payment is made to the holders of any stock other than the Class A Preferred stock. Any assets thereafter remaining shall be dis-

tributable among holders of stock other than the Class A Preferred stock in accordance with their rights at the time of the distribution."[1]

[fol. 47] A liquidation and dissolution of Power is taking place.[2] The argument that by some strange legal alchemy the disposition of the assets of Power and its enforced dissolution is not really a liquidation at all falls in face of the facts, one of the more important of which is that when the preferred stock was issued and sold to the public, then as now the principal asset of Power was the common stock of Railways. When the incorporators wrote the charter fixing the rights of stockholders upon involuntary dissolution, plainly they were talking about the rights of Power's stockholders to its holdings of Railways' securities.

In my opinion, insisting that the stockholders observe the terms of their contracts is not the application of a bankruptcy technique. It is clear that the preferred stockholders are not receiving that to which the contract entitles them. Involuntary dissolution and liquidation are taking place. The preferred is thereupon entitled to receive from the net assets, whether capital or surplus,[3] for each share of stock,

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[1] The amended charter (1929) also contains the following:

"The Common Stock of the Company shall be subject to the rights of the holders of the Class A Preferred stock."

[2] This Commission's order of March 20, 1941, pursuant to which this plan was submitted (and certain previous disposition of Power's assets undertaken), provided that Power "shall be liquidated and dissolved." Holding Company Act Release No. 2636. The Second Circuit Court of Appeals, in reviewing this Commission's order permitting the retirement of Power's publicly held debentures without payment of a premium (undertaken in order to comply with our order of March 20, 1941), regarded the retirement of debentures as one step in "the liquidation and dissolution of Power." *New York Trust Co. v. Securities and Exchange Commission*, 131 F. (2d) 274 (C. C. A. 2nd, 1942).

[3] In case of liquidation or dissolution arrearages on preferred stock, where the charter contains such provisions, must be paid before any payment is made to the common even if the use of capital is thereby necessitated. See *Willson v. Laconia Car Co.*, 176 N. E. 182 (Mass. 1931); *Cox v.*

$100 plus arrearages $64.50 (to December 31, 1942) or $164.50, or for 600,000 shares a total of $98,700,000 before any payment in money or kind is made to the common stock. I agree that the preferred stockholders are not entitled to [fol. 48] be paid in cash in the present circumstances. I agree it is appropriate to pay them in kind. In this case they are being paid with common shares of Railways. It is agreed by the majority that the Railways common to be paid them, or indeed all of it including what is not being delivered to them, is not worth $98,700,000, or anywhere near it, either on an asset basis or any reasonable capitalization of foreseeable earnings or indeed on any basis. Yet the Power common is getting 5.48% or 173,838 shares of Railways common with a par value of $1,216,866 and a consolidated book value of about $4,450,000 before the charter provision as to the preferred has been honored. I regard this as a breach of the contract. I think it flagrantly disregards the rights of the preferred stockholders.[3a] The Circuit Court of Appeals for the Second Circuit in the course of dealing with one stage of this very dissolution of this company, in denying the right of the bondholders to be paid a premium said:

> "The order under review [i. e., the S. E. C. order of February 25, 1942] was, accordingly, fair and reason-

Sellers, 28 A. (2d) 679 (Del. 1942). The right to accrued dividends is treated as a "vested right." See the *Laconia Car* case; *Morris v. American Public Utilities Co.*, 122 Atl. 696 (Del. 1923); *Pennington v. Commonwealth Holding Const. Corporation*, 155 Atl. 514 (Del. 1931); *Consolidated Film Industries v. Johnson*, 197 Atl. 489 (Del. 1937); *Roberts v. Roberts-Wicks Co.*, 77 N. E. 13 (N. Y. 1906). [Cf. *Davison v. Parke, Austin & Lipscomb, Inc.*, 35 N. E. (2d) 618 (N. Y. 1941) which, while throwing doubt on the constitutional implications of the "vested rights" principle enunciated in earlier New York cases, asserted that the legislature had not intended in the instance to allow preferred stockholders to be deprived of their charter right to accrued dividends.]

[3a] In the majority opinion in the Federal Water Service case (—S. E. C. p.—) there was a concession that, had the case involved a liquidation, the opinion would have had a different result. This dictum is now rejected in the majority opinion.

able to all parties in interest since it provided for the payment of the bonds *in a way which discharged in full the contract obligations of the dissolved corporation.*" See *New York Trust Co. v. Securities and Exchange Commission*, 131 F. (2d) 274. (Emphasis supplied.)

So now the plan of dissolution and the order approving it are not fair and equitable to all parties in interest since it does not provide for a treatment of the preferred in a way which conforms to the charter. When this Commission issued its orders in the bond premium cases, one involving Power and the other North American Light & Power, it rested its decisions squarely upon the contract provisions [fol. 49] as to the rights of bondholders upon involuntary dissolution. When the Circuit Court of Appeals for the Seventh Circuit affirmed our order in the North American Light & Power case (on March 5, 1943) it said that the petitioners who were seeking a premium on debentures must stand or fall on the issue as to whether North American Light & Power was required by contract to pay a premium on redemption under the circumstances with which it was confronted. The Court said the principal question presented was whether the debenture holders had a contract right to the payment of a premium upon redemption of the debentures occasioned by the involuntary act of Light & Power. The Court answered this question in the negative. Plainly it based its decision, as we based ours, upon the specification in the contract as to how the debentures should be treated in involuntary dissolution. See *City National Bank and Trust Company v. Securities and Exchange Commission*, — F. (2d) — (C. C. A. 7th, 1943). I rest this dissent upon the contract provision as to the rights of the preferred upon involuntary dissolution.

The majority opinion rejects this view on several grounds.

It says that dissolution under this Act was not foreseen and was not in the minds of the incorporators when the charter was written. I agree. However, what was in their minds, what was foreseen and provided for, was that there might be dissolutions from unforeseeable and unpreventable causes. The parties in the charter fixed their rights of participation in case of voluntary or involuntary dissolution of Power. They made possible also redemp-

tion of the preferred stock. As redemption would be within the control of the company, it was recognized that it would be unfair to redeem the preferred at ordinary liquidation value in view of the fact that it had accepted a limited return on its investment. In event of redemption, therefore, the preferred was to receive an additional premium of $5.00 per share. No premium was provided in case of in- [fol. 50] voluntary dissolution, in view of the fact that this would be beyond the control of all classes of stock.

With knowledge of the possibility of enforced liquidation and dissolution in mind, the incorporators provided that, in case of involuntary liquidation, the preferred must receive $100 per share and arrearages before the common got anything. The common thereby assumed the risk that if, through no fault of either class of stockholders, the company should be required to go out of existence because of unforeseen circumstances, the preferred would be paid its full liquidating value (including arrearages), which might leave the common nothing. The common's right was to unlimited participation in assets not subject to superior claims.

The charter made provision for the rights of stockholders upon dissolution or liquidation of the corporation, whether voluntary or involuntary. When provision is made for distribution rights upon either voluntary or involuntary dissolution, provision is made for every possible kind of dissolution.

What was meant to be covered by involuntary liquidation except the unpredictable and the unpreventable? It need not be just insolvency or money troubles. It might be a dissolution action under the Sherman Act, the Clayton Act, the Hepburn Act, a *quo warranto* by the state attorney general, or any action that a superior authority might compel. The authority which forces involuntary dissolution is usually that of the government.[4]

The resemblance of proceedings under Section 11 (b) to proceedings under the Sherman Act and the Hepburn Act was pointed out by the committee reporting this bill

[4] Under most state laws a charter is accepted, generally speaking, subject to the right of the state to terminate it. See Note: Power of State to Alter Corporate Charters, 31 Col. L. Rev. 1163 (1931).

to the Senate. Footnote 16 of the majority opinion calls attention to that report. The Senate report, as footnote 17 of the majority opinion points out, in connection with Section 11 (b), speaks of the courts exercising all the extraor- [fol. 51] dinary powers such courts have been accustomed to exercise when called upon under the Sherman and Hepburn Acts to effect compulsory corporate readjustments required by the public policy expressed in those Acts. There were other similar references which need not be repeated. It therefore appears that Congress in enacting Section 11 had definitely in mind precedents under the Sherman Act and the Hepburn Act.

An examination of cases which arose under those Acts and which were decided by the Supreme Court before 1935 discloses that, instead of sustaining the position of the majority, the opposite view is found to be sustained. In the hearings before Congress probably no precedent of the courts was so often cited as the decision of the Supreme Court in the *Reading* case.[5] The Reading Company was required, as a combination in violation of the Sherman and Hepburn Acts,[6] to confine itself to ownership and operation of a railroad system, and to dispose, *inter alia*, of its interest in a coal business. In *United States v. Reading Co.*, (273 Fed. 848, (D. C. E. D. Pa., 1921)), the District Court, upon the mandate of the Supreme Court in 253 U. S. 26, approved a plan for the liquidation and dissolution of Reading, and provided for distribution in kind of the surplus of Reading to its preferred and common stockholders, who were to receive, share and share alike, assignable certificates of interest in the stock of the new company formed to take over Reading's coal business. Common stockholders of Reading contended that *under the charter* of Reading, the distribution of its surplus should go to common stockholders only, and this question came before the Supreme Court. *Continental Ins. Co. v. United States*, 259 U. S. 156 (1922).

The preferred and common stock of Reading consisted of an equal number of voting shares at $50 par value. The

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[5] See e. g. remarks of Senator Wheeler, 79 Cong. Rec. 4605-4607, 8432 (1935); Mr. Eicher, 79 Cong. Rec. 10361-2 (1935).

[6] *U. S. v. Reading Co.*, (1920) 253 U. S. 26.

[fol. 52] preferred was entitled to 4 percent non-cumulative dividends and was subject to redemption at par (in cash), (259 U. S. 156, at 179). The charter did not give the preferred stock any preference upon liquidation or distribution.

The contention of the common stockholders that they were entitled to the surplus of Reading to the exclusion of preferred stockholders was dismissed by the Supreme Court upon its interpretation of the Reading charter (259 U. S. 156, at 177-181). At page 181, the Court said that "stockholders, common and preferred, share alike in the assets of a liquidating corporation, if the preference *is only as to dividends.*" [citing cases] (emphasis supplied).

Starting with the Supreme Court's premise that in a liquidation and dissolution compelled by federal law the rights of preferred and common stockholders *inter sese* are to be determined *by their contract*,[7] the conclusion is inescapable that preferred stockholders who are entitled to liquidation preferences must be paid such preferences in full before common stockholders are permitted to participate. A statement made by the management of Reading in connection with an application to the New York Stock Exchange for stock listing, that "the preferred and common stock * * * in liquidation or dissolution of the corporation, will share equally in pro rata distribution of assets" was regarded by the Supreme Court as shedding light on "the kind of interests they were buying in the company" (259 U. S. 156, at 180-181). It was considered by the Supreme Court in determining the participation in the Reading liquidation under the anti-trust laws.[8] *A for-*

[7] See also *Standard Oil Co. v. United States*, 221 U. S. 1 (1911), and *United States v. American Tobacco Co.*, 221 U. S. 106 (1911), as to the determination of the Supreme Court to effect dissolution in accordance with the contract rights of the security holders. This was emphasized in another part of the *Continental Co.* case in 259 U. S., in which provision was made to protect mortgage bondholders whose mortgage covered the property of both Reading and the coal company prior to the dissolution. See 259 U. S. 156, at pp. 167-174.

[8] I must confess to a feeling that the charter provisions themselves are of greater weight than representations in

[fol. 53] *fiori*, a charter provision, as here, expressly granting to preferred stockholders a preference to the extent of $100 a share plus accumulated dividend arrearages "upon the dissolution or liquidation of the corporation, whether voluntary or involuntary" must be respected by us, and the liquidating preferences and arrearages paid to the preferred before the common can participate.

The *Reading* case (and the *American Tobacco* case) convince me that rights among stockholders are to be determined according to their contracts when involuntary dissolution is forced by a federal statute.

Because United has assets insufficiently to satisfy in full the liquidating preference of its preferred stockholders, I consider it not fair and equitable to permit its common stockholders to participate in such assets as are available for distribution.

Any intimation that this is the equivalent of the destruction of investment values is unwarranted. Both the majority and I are in complete accord that the value of these assets is substantially less than the liquidating value of the preferred including arrearages. I am also in complete accord with the majority that the elimination of unnecessary companies and simplification of structures do not destroy values but do destroy needless expenses and so improve the investment values of the securities involved.

II

In my view, as expressed heretofore, the action to be taken by Power will constitute liquidation and dissolution within the meaning of its charter. So my dissent rests on the fact that the preferreds' liquidation preferences and arrearages are not protected in the order of the Commission. If, however, the disposition of the assets of Power and its subsequent dissolution must be treated not as a liquidation and [fol. 54] dissolution within the meaning of its charter but

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listing applications. Nevertheless, I point out what appears in a certified copy of the application made by Power for listing its preferred stock on the Chicago Stock Exchange. Item N in the ap-lication reads: "Preference or other rights upon distribution of assets". The sworn answer is: "Preference over all other stocks of company in liquidation."

as a reorganization or recapitalization, then I regard the treatment of the preferred as not fair and equitable. My views on this matter have been expressed in my dissents in the *International Paper and Power Company* case, 2 S. E. C. 274 at 285 ff. (1937), and the *Federal Water Service Corporation* case, 8 S. E. C. 893, at 921 ff. (1941).

I regard the question, "Is the plan fair and equitable?" as one of law. I do not regard it as a matter of administrative grace or the uncontrolled discretion of the Commission. Undoubtedly, it involves the exercise of judgment by the Commission but its correct decision should rest upon, or at least be consonant with principles of law and contract established by the courts. If the words "fair and equitable" mean whatever we say they mean, if their meaning is not a matter of law, then my conclusion, based on my observation and experience as a Commissioner, and on my views as to the Act itself, is that "fair and equitable" ought to mean that in reorganizations under this Act as elsewhere the principle of absolute priorities prevails.[9] A decent regard for the rights of security holders under financial contracts leads me to no different result. The absolute priority doctrine

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[9] For my part I prefer that our conclusions as to the meaning of words in our statutes be treated as matters of law subject to court review, and that our conclusions be given great weight by the courts in arriving at their own conclusions because of our experience and duties under those statutes. Such was the established view of the Supreme Court for many years following its decision in *Federal Trade Commission v. Gratz*, 253 U. S. 421 (1920). (Cf. *Standard Oil Co. of N. Y. v. Federal Trade Commission*, 273 Fed. 478 (C. C. A. 2, 1921 where the holding of the *Gratz* case was applied in the following language at p. 481: "Whatever may be the exact meaning or extreme scope of the still novel phrase 'unfair method of competition', it is settled that it is for the courts and not the Commission to determine as matter of law what is and what is not included in the phrase.") If such is not the rule I cannot see that the doctrine of the supremacy of law in America is in force. It seems to me the supporters of a contrary view (and this does not include any of my brother Commissioners) are merely passing the ammunition to those who oppose the administrative process.

is not a variation from normal law. It is not in law what a sport is in biology. It rests on the superior position which a creditor holds as against stockholders, which the stockholder with full preferences as to assets and earnings holds [fol. 55] as against the common stockholder. Whenever those superior rights are threatened with mistreatment, whether through conveyances in fraud of their rights, or waste, or allocation of securities in reorganization, or the distribution of assets in liquidation, the law recognizes and protects that superiority of position.

My views proceed from the same basic premises which caused me to dissent in the *Federal Water Service Corp.* case (8 S. E. C. 893). I shall repeat those premises without repeating the arguments or citations I included in that dissent, except to the extent that new arguments contrary to my views appear in the opinion herein.

The first premise is that the expression "fair and equitable" found in Sections 11 (c) and 11 (d) is a term of art having a settled meaning, requiring the application of the principle of absolute priorities to the reorganization of corporations.[10] The Supreme Court has repeatedly held that where language used in a statute had acquired a settled meaning in court decisions, Congress will be presumed to have used the language to convey that meaning. That is what the Court held in the *Los Angeles Lumber* case when it passed on the words "fair and equitable," which in 1934 had been lifted out of the equity receivership cases and transferred to Section 77(b) of the Bankruptcy Act.[11] The phrase "fair and equitable" had a settled meaning when Congress used it in 77 (b) in 1934. It still had it when Congress used it again a year later in 1935 in the Holding

[10] Compare *Group of Institutional Investors and Mutual Savings Bank Group v. Chicago, Milwaukee, St. P. & Pac. R. R. Co.*, Nos. 11-19, 32, and *Ecker v. Western Pacific Railroad Corp.*, Nos. 7, 8, 20, 33 and 61, decided by the Supreme Court March 15, 1943, — U. S. —.

[11] This Commission took the same position as to the term "trade secret" in Section 24 (a) of the Securities Exchange Act of 1934 in its brief in the *Sumatra Tobacco Company* case and was sustained therein by the Court of Appeals for the District of Columbia. See *American Sumatra Tobacco Corporation v. Securities and Exchange Commission*, 93 F. (2d) 236 (1937).

Company Act, an Act which Congress knew would inevitably involve liquidations and reorganizations. The settled meaning connoted the absolute priorities doctrine.

[Vol. 56] The second premise is that the settled meaning of "fair and equitable" described in my first premise applies to the reorganization of solvent corporations.[12]

The third premise is that the absolute priority rule applies as between classes of stockholders.[13]

These three premises add up to the conclusion that in this reorganization the common stock can participate only if (1) the preferred stock is completely compensated for all it surrenders, i. e., its prior claim on earnings, its prior claim on assets in case of liquidation, and its claim to ac-

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[12] *Du Bois v. Consolidated Rock Products Co., Inc.*, 312 U. S. 519 (1941).

[13] This premise rests on a number of lower federal court cases cited in Footnote 13 of my opinion in the *Federal Water Service* case. The precise question, so far as I am aware, has not been passed on by the Supreme Court, although it has been approved by implication in *Taylor v. Standard Gas & Electric Co.*, 306 U. S. 307 (1939) where the court did not find unfair that aspect of the plan before it which granted participation to the old preferred while denying it to the old common. The Supreme Court in the *Los Angeles Lumber* case has also cited several cases so holding: *Flershem v. National Radiator Corporation*, 64 F. (2d) 847 (C. C. A. 3, 1933) (rev'd for reasons not relevant here, 290 U. S. 504 (1934)); *In re New York Railways*, 82 F. (2d) 739 (C. C. A. 2, 1936) cert. den. 298 U. S. 687; *In re Day & Meyer, Murray & Young*, 93 F. (2d) 657 (C. C. A. 2, 1938). See also *In re Consolidation Coal Co.*, 11 F. Supp. 594 (1935); *In re Oscar Nebel Company, Inc.*, 115 F. (2d) 141 (C. C. A. 3, 1940). In its brief in the last case, this Commission expressly took the position that the absolute priorities doctrine applies between classes of stockholders. Apparently Judge Jerome Frank, now of the Circuit Court of Appeals for the Second Circuit and formerly Chairman of this Commission, whose views greatly influenced the majority opinion of this Commission in the *Federal Water Service* case, took a contrary view some years ago. See: Frank, Some Realistic Reflections on Some Aspects of Corporate Re-Organization, 19 Va. L. Rev. 541 (1932).

cumulated arrearges and (2) there is a value remaining for the common after these rights have been fully compensated. I cannot find that there is a value remaining for the common in this case.

III

I now turn to the questions: (1) Does the plan fully compensate the preferred for all it surrenders? (2) Is there a value remaining for the common after the preferred's rights have been fully compensated?[14]

I recognize fully that in valuing enterprises either in liquidation or for reorganization purposes rigid formulae [fol. 57] should not be insisted upon. I recognize also that forecasts of earnings cannot be exact and at best are no more than estimates. With the principle, however, that the absolute priorities doctrine applies as between the preferred stock and the common, and that this right of the preferred is to be measured by its liquidating value, including its arrearages and its claim on earnings, I am unwilling to consider any compromise.

The Asset Basis

I consider these questions first on an asset basis. I agree with the opinion that this basis is not conclusive. It is important, however, because of its bearing on earnings and for other reasons. The subsidiaries from which earnings originate are, for the most part, operating public utility companies. Their rates may be assumed to be made on rate bases derived from either original cost, prudent investment, present value, or a combination of them. In rate making, where present value is used, values are used in the determination of earnings; earnings are not used to determine values.

The opinion states that "The assets of Power are, in our opinion, of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942."

At April 30, 1942, the balance sheet of Power[15] carried

[14] This is on the assumption which I cannot accept that we are dealing with some kind of reorganization and not a liquidation.

[15] A condensed balance sheet of Power at April 30, 1942 is given in the opinion.

the preferred stock at $60,000,000, and the common stock at $13,907,072. There was a deficit in earned surplus of $1,843,832. If the preferred's dividend arrearages of $36,300,000 at that date were taken into account, the deficit would be increased to $38,143,832 and the common stock would be wiped out; in fact, it would be $24,236,760 "underwater". In other words, net assets would be $24,236,760 less than enough to satisfy the liquidation preference of Power's preferred including its arrearages.

[fol. 58] The principal asset of Power is the common stock of Railways. At April 30, 1942 the book value applicable to Railways' common stock was $77,954,874 on a corporate basis and $81,554,330 on a consolidated basis. Both figures are *pro forma*, after giving effect to contributions by Power of certain assets.[16] On this basis, the liquidation preference of Power's preferred, including arrearages of $36,300,000, exceeds the book value of Railways' common by $18,345,126 on a corporate basis, or $14,745,670 on a consolidated basis. In other words, even if the preferred stockholders were given all of Railways' common stock, they would still not receive anything equal to the face amount of their present claim.[17]

However, the net asset figures of $77,954,874 and $81,554,330 representing the book value of Railways' common stock, are open to challenge. Moreover, they are reached only after deducting very substantial amounts of senior security claims.

At April 30, 1942 Railways' consolidated balance sheet showed net assets applicable to outstanding securities of $431,732,669. Claims senior to Railways' common stock aggregated $350,178,339. The balance of $81,554,330, only

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[16] *Pro forma* corporate and consolidated balance sheets of Railways at April 30, 1942, are given in exhibits to the opinion.

[17] As Justice Douglas pointed out in the *Chicago, Milwaukee, St. Paul & Pacific R. R. Co.* case, — U. S. —, "The second of these objections is that General Mortgage bonds are to receive under the plan only a face amount of inferior securities equal to the face amount of their claims. The objection would, of course, not be valid if claimants wholly junior to the General Mortgage bonds were not participating in the plan. * * *"

about one-fifth of the total, is all that remains for Railways' common stock. This amount may be broken down into its principal components as follows:

[fol. 59]

TABLE I

Pro Forma Consolidated
Net Assets at April 30, 1942

Utility Plant (including intangibles)	
Combined property accounts of subsidiaries	$391,372,776
Excess of carrying value of investments in securities of subsidiaries over underlying book value at dates of acquisition	38,441,561
	$429,814,337
Reserve for depreciation	85,525,628
	$344,288,709
Investments (net)	55,512,801
Other assets (net)	15,389,528
Deferred charges (net)	16,541,631
	$431,732,669
Claims of senior securities	350,178,339
Balance applicable to Railways' common stock [18]	$ 81,554,330

[18] These balance sheets give effect to the proposed contribution to Railways of Power's net assets except La Porte Gas and Electric Company and, of course, the common stock of Railways. As to La Porte, the opinion indicates that if it is not sold within the time scheduled for liquidation of Power it will be transferred to Railways and appropriate arrangements made to provide for Power's bank loan, miscellaneous debts and the expense of liquidation. A note to the *pro forma* corporate balance sheet of Railways (which excludes La Porte) merely states that if it were not sold "the *pro forma* investment account and current liabilities would be increased by $1,500,000." It seems very clear to me that the value and probable proceeds from

[fol. 60] The consolidated net assets of $81,554,330 ($77,954,874 on a corporate basis) as shown in Table I are, however, subject to substantial reductions. Shown as part of utility plant is $38,441,561 described as the "Excess of carrying value of investments in securities of subsidiaries over underlying book value at dates of acquisition." This is in addition to the amounts which are included directly in the 100.5 and 107 accounts of the operating companies. It arises in consolidation because the underlying book values of the subsidiaries at dates of acquisition are that much less than the amounts at which the investments representing such underlying book values are carried by the respective holding and sub-holding companies. The balance sheets attached as exhibits to the opinion do not show the basis on which investments are carried and the description of this excess contained in such balance sheets does not call

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the sale of La Porte exceed the $1,500,000 of bank loans. The other net assets of Power, which are being contributed to Railways, consist of the following:

Special escrow deposit *	$1,358,442
Investments in Mason City and Clear Lake R. R. Co.	150,000
Deferred Charges	60,841
Current Assets	433,918
	$2,003,201

* Assuming that the order of this Commission, affirmed in *The New York Trust Co.* case, is not overruled. See opinion note 15 and related text.

This aspect of the liquidation of Power, although not at all emphasized in the opinion, is important because at present the Power preferred stock has a direct and prior claim on Power's assets in excess of its liabilities.

The point is that under the proposed plan, the preferred loses completely its direct and prior rights in these assets and is given only 95% of the Railways' common stock. Since it is being given common stock, its rights become subordinated to $23,837,000 of Railways' debentures, $18,983,800 of preferred stock and more than $1,100,000 of current debt.

it "Excess of cost of investments * * *," it refers to it as "Excess of carrying value of investments * * *." If it represented actual excess *cost* I believe it would be so described.

In any event, the amount is open to question, since it is a well known fact that many holding companies in the past paid exorbitant prices for the controlling stock of op- [fol. 61] erating companies. To what extent this excess if supported or not supported by values is not explained and I am unwilling to accept it without knowing. Any necessary downward adjustment would further decrease the amount of net assets applicable to Railway's common stock.

Investments are shown at $55,512,801. The investments in The Detroit Edison Company and in International Paper Company are carried at an amount about $15,000,000 in excess of the amount which Power's management estimates they are worth, as indicated in note e to the pro forma consolidated balance sheet of Railways at April 30, 1942 given in Exhibit C of the opinion. In Power's annual report for 1942, however, the accountant's certificate indicates that the carrying value of the investment in The Detroit Edison Company exceeded quoted market value at December 31, 1942 by $25,123,100. Clearly the amount of $81,554,000 should be adjusted downward for the substantial portion (over 50%) of the decline in the value of these investments which is not assignable to the minority interest.[19]

At April 30, 1942 utility plant, including intangibles, contained an amount of $8,979,909 classified in Account 107, where pure write-up representing no investment in the property is carried. While this amount should be elim-

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[19] The investment in the common stock of International Paper Company, carried at $3,788,569, was sold in December of 1942 for $458,828—a loss actually realized of $3,329,741. At December 31, 1942, the quoted market value of the investment in 1,289,205 shares of common stock of The Detroit Edison Company was $25,123,100 less than its carrying value of about $36¾ per share. This difference is computed on the basis of a quoted market price of 17¼. The high for 1943 is 19½, the low 16⅞ and the close on March 31, 1943, 18½.

inated from the accounts, it is not determinable at this time how much may be charged against the depreciation reserve and how much will be charged against the minority interest. Since April 30, 1942, the amount of $8,979,909 has been reduced to about $5,800,000 partly as a result of a write-off (in large part against the depreciation reserve) made by Kansas City Power and Light Company pursuant [fol. 62] to an order of the Federal Power Commission. Utility plant also includes over $8,600,000 classified in Account 100.5 the account designed to include the excess of cost over original cost. It is true that part of the $8,600,000 is chargeable against the minority interest and some portion of it may be disposed of by a charge against the depreciation reserve. Nevertheless, the provisions of the classifications of accounts which govern this item are a constant threat to its continuance and to the portion of the $8,600,000 included in the $81,554,330.

Deferred charges in the net amount of $16,541,631 shown in Table I consist of $17,412,210 of debt discount and expense (of which over $11,000,000 applied to refunded issues) less $4,798,508 of debt premium and expense, gas conversion expenditures of $1,284,333, appraisal and audit expenses of $382,261 and miscellaneous items of $2,261,335. These amounts for the most part do not represent assets in the usual sense of the word. They generally have no value in liquidation and often are required to be eliminated in reorganization.

To sum up, I repeat that the claim of the preferred at April 30, 1942 is $60,000,000 plus $36,300,000 for dividends in arrears or $96,300,000. The consolidated net assets of Railways applicable to its common stock at April 30, 1942 are shown on a book value basis to be $81,554,330 or $14,745,670 [20] less than the claim of the preferred at the same date, and the book values are subject to the criticisms I have noted. It is not necessary to reduce to precise figures the adjustments which I have previously indicated should be made. My point is that on a realistic basis the

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[20] It is not possible to give the amount of this deficiency at December 31, 1942. While the claim of the preferred increases to $98,700,000 by reason of accruing dividends, the net earnings of the system to the end of the year would also have to be taken into account.

[fol. 63] deficiency is substantially more than $14,745,670 on a consolidated basis or $18,345,126 on a corporate basis.[21]

The Earnings Basis

I next consider the questions, whether the preferred is being fully compensated and whether there is a value thereafter for the common, on an earnings basis.[22] In a valuation for reorganization purposes capitalization of earnings is recognized as the principal criterion.[23]

The opinion states: "Similarly, on the basis of a capitalization of reasonably anticipated earnings of the enterprise we are unable to find an over-all value of the assets which approaches $98,700,000." I concur. I shall show later why it seems to me that on any realistic basis of capitalizing earnings the system assets fall far short of $98,700,000.

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[21] Market quotations for the stocks have been as follows:

[22] I have already agreed that "book values" are not controlling.

[23] *Dubois* v. *Consolidated Rock Products Co., Inc.*, 312 U. S. 510 (1941); *Ecker* v. *Western Pacific R. R. Co.*,— U. S.—(March 15, 1943); *Group of Institutional Investors, etc.*, v. *C. M. St. Paul & P. R. R. Co.*,—U. S.—(March 15, 1943). The last two cases raise questions on the appropriate manner of carrying out the principles of the *Consolidated Rock* case with respect to valuation. Another pending case involving valuation where the plan was upheld is: *In re Chicago & Northwestern Ry. Co.*, 126 F. (2d) 351 (C. C. A. 7, 1942), affirming 35 F. Supp. 230. See also: *In re St. Louis-San Francisco Ry. Co.*, 46 F. Supp. 120; *Akron, C. & Y. R. Co.* v. *Hagenbuch*, 128 F. (2d) 932 (C. C. A. 6, 1942).

United Light & Power Company

Market Quotations

Year	$6 Cumulative Convertible First Preferred Class A No Par High	Low	Class A Non-Voting Common High	Low	Class B Common High	Low
1929	110[1]	100[2]	61 7/8	20	125	32
1930	119 3/8	87	56	19 3/8	99 7/8	56
1931	104 1/4	35 3/4	34 1/2	5 3/8	69	10 3/8
1932	53 5/8	8 1/4	9 1/4	1 3/4	14	4
1933	41 1/2	7	9 3/4	1 3/4	12 3/4	2 1/2
1934	24 3/4	5	5 1/8	5/8	6 1/4	1 1/2
1935	31 1/2	3 1/2	3 5/8	5/8	7	1
1936	68	29 1/4	8 3/4	3 3/8	9 1/2	2 3/4
1937	75 7/8	14 1/2	11 3/8	1 7/8	11 1/2	2 1/4
1938	34 1/4	13 1/2	4	1 3/8	4 1/2	1 3/4
1939	36 1/2	19	3	1	2 7/8	7/8
1940	36	16 3/4	1 3/8	5/16	1 1/4	11/16
1941	29 1/2	16 1/2	7/16	3/32	7/16	3/32
1942	23	10 1/2	3/8	1/8	5/16	1/8
3/31-1943	34 3/8	33 3/4	1/2	1/2	1/2	1/2

[1] Offering price in Oct. 1929.
[2] Offering price in May 1929.

[fol. 64] I believe that the best method of valuation for reorganization purposes [24] is to be found in a capitalization of reasonably foreseeable earnings or earning power at an appropriate rate. This is the method which I think ought to be adopted in this case. In addition and more importantly it is consistent with the holding in the *Consolidated Rock* case, in the *Western Pacific R. R. Co.* case and in the *C. M. St. P. & P. R. R. Co.* case. In the *Consolidated Rock* case it was said that the value of the assets of the enterprise must be ascertained in order to determine the appropriate allocation of new securities among the old security holders. As to the method of valuation (one of the main points of difference in this case) it was said that an effort must be made "to value the *whole enterprise* by a capitalization of prospective earnings * * * Findings as to the earning capacity of an enterprise are essential to a determination of the feasibility as well as the fairness of a plan of reorganization. Whether or not the earnings may reasonably be expected to meet the in-

[24] The opinion contends that this is a reorganization. While I disagree with this contention, the principles of valuation should not, in this case, be different because the common stock of Railways has to be valued whether we view it as a reorganization or a liquidation.

terest and dividend requirements of the new securities is a *sine qua non* to a determination of the integrity and practicality of the new capital structure. *It is also essential for satisfaction of the absolute priority rule of Case v. Los Angeles Lumber Products Company. Unless meticulous regard for earning capacity be had, indefensible participation of* junior equities in plans of reorganization may result." [25]

I treat the earnings as we have treated them in dozens of reorganization cases under Chapter X of the Bankruptcy Act.[26] That method is as follows:

[fol. 65] I assume for the moment, and only for the moment, annual earnings of $6,185,000 which the opinion characterizes as "a very liberal assumption as to earning power." Capitalizing this amount at a 10% rate, I arrive at a maximum over-all valuation of $61,850,000.[27] This is $36,850,000 less than the claim of the preferred at December 31, 1942, and only $850,000 more than the cash paid by the preferred about 14 years ago.[28]

Thus it appears that valuing the principal asset of Power (the common stock of Railways) on a "very liberal" earnings basis and at too low a rate by the method customarily used by the Commission in reorganization cases indicates

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[25] Compare statement by the late Justice Brandeis speaking for a unanimous Court in 1935 in *Atlanta, Birmingham & Coast R. R. Co.* v. *United States*, 296 U. S. 33 (1935).

[26] See e. g., *McKesson & Robbins, Inc.*, 8 S. E. C. 853 (1941); *The Higbee Company*, 8 S. E. C. 777 (1941); *La France Industries*, 5 S. E. C. 917 (1939); Griess-Pfleger Tanning Co., 5 S. E. C. 917 (1939).

[27] 10% is in my judgment too low. The data in footnote 11 of the opinion indicate average times—earnings rates of from 8.9 to 10.4 for nine "representative public-utility holding companies." However, it is clear to me that Railways is not as strong a company as most of the companies included in those averages.

[28] According to Moody's Manual 500,000 shares were offered at par and 100,000 shares at 110. This totals $61,000,000. From the record in this case it appears that the proceeds to the company were $58,594,000. The difference of $2,406,000 apparently represents the underwriting spread.

there is no value for the common stock and no basis for its participation. Accepting the rate of 10% and the opinion's findings as to earning power, the preferred is barely being compensated for the cash paid by it 14 years ago. It is not being compensated for its arrearages nor for the prior rights which it surrenders.

The over-all valuation method of capitalizing earnings has been used by the Commission under Chapter X in determining equities among different classes of debt securities and between debt securities and stock. I doubt that any case can be cited under the Bankruptcy Act where we have failed to take this position. Usually it has been given controlling weight.

This has been true whether the debt securities in question were matured or merely deemed to be matured. I do not believe that a claim that the absolute priorities doctrine does not apply in case of debt securities not yet matured could be sustained, or that a Chapter X case can be cited where we have taken that stand. In the *Los Angeles Lum-*
[fol. 66] *ber Company* case one of the reasons given by the District Court for permitting participation by the stockholders in the plan of reorganization was that "by reason of the so-called voluntary reorganization in 1930, the bondholders cannot foreclose until 1944, the old stockholders having the right to manage and control the debtor until that time." In his opinion, Mr. Justice Douglas said that this reason had no validity.

The bonds there were income bonds and the court was unaware of any circumstances which would give the bondholders the right to accelerate the maturity. The court accepted the conclusion that the bondholders and the trustee could not take possession of the property through foreclosure or otherwise until the maturity of the bonds, and, as a corollary, that the stockholders could keep their possession and control until that time. The court *assumed* "that this right or power on the part of the stockholders to keep possession until 1944 was for them a *thing of value*, though there is no finding that the old stock had any value, present or prospective." The court held that that right did not survive the commencement of proceedings under Section 77B. By invoking the aid of the court, the debtor as well as the creditor assumed all the consequences which flow from that jurisdiction, among them, the possibility that

a plan will be approved which eliminates the stockholders completely.

Thus although the court recognized that the bonds were not due and recognized the right of the common stockholders to continue to operate the business as a thing of value, it did not permit that right to interfere with the imposition of the absolute priorities rule, and the giving up of that right did not constitute grounds, by and of itself, for participation of the common.

It is now well established in some jurisdictions that a creditor's claim need not be matured in order that he may restrict his debtor's free disposition of assets. The Uniform Fraudulent Conveyance Act gives him the same right [fol. 67] in this respect as the creditor with a matured claim reduced to judgment. Likewise, the preferred stockholder now has definite standing in court to challenge acts of the company which may be unlawfully detrimental to his interest in the company.[29]

However, it is not possible for me to accept the figure of $6,185,000 which the opinion uses "for the purpose of determining the existing rights of the preferred and common stocks in the enterprise." To arrive at this figure the actual consolidated net income of Railways and its subsidiaries for the five years ended with 1941, together with estimated figures for 1942, are first adjusted to reflect the Railways' system as it was constituted on April 30, 1942. Next, adjustments averaging $769,425 yearly are made for so-called non-recurring charges which were "urged by the management as necessary to a determination of the normal earning power of the system." The result is $6,185,000. My reasons for not being able to accept this figure of $6,185,000 are many.

I begin with the first table of earnings shown in the opinion. This table covers the earnings of Power's system for the period from 1929, when the preferred stock was sold for cash, to 1942, inclusive. All these figures are represented to be actual except those for 1942 which include estimated amounts for the last three months of that year. Ac-

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[29] *Crimmins & Peirce Co. v. Peabody Acceptance Corporation*, 185 N. E. 383 (Mass. 1933); *Tower Hill Connellsville Coke Co. v. Piedmont Coal Co.*, 33 F. (2d) 703 (C. C. A. 4, 1929); See *General Investment Co. v. American Hide & Leather Co.*, 129 Atl. 245 (N. J. 1925).

cording to the table, preferred dividends were earned and paid on both a corporate and on a consolidated basis through 1931. In 1932 they were earned on both bases, but only ¼ of the preferred dividend requirement, or $900,000, was paid in that year. From 1933 to 1942 the annual preferred requirements of $3,600,000 were never earned on a corporate basis, nor paid. Even on a consolidated basis they were *not* earned in four years, 1933, 1934, 1935 and 1938. While 1938 was a poor year generally for utilities, the failure [fol. 68] to earn the preferred dividend requirement in that year is significant since it shows clearly the effect of leverage in the system. A recession in 1938 of about $2,500,000 in the underlying *gross* revenues was accompanied by a decline of over $2,000,000 in the consolidated *net* income of the system. It may also be noted that on the basis of actual annual consolidated earnings reported since 1932, the low is $986,719 and the high is $6,700,000[30] and the average is $3,840,000—only $240,000 more than the preferred's annual requirements but $2,345,000 short of the assumed earnings of $6,185,000.

Perhaps the most interesting point about this table is that it shows the aggregate preferred dividend requirements for the 13 year period ended December 31, 1941 to have been actually earned on a consolidated basis with $18,478,747 to spare. Of this excess shown, $8,752,796 was paid in common dividends in 1929, 1930 and 1931 which leaves $9,725,951. Add to this the balance of consolidated earned surplus of $7,144,624 at January 1, 1929 and the $35,100,000 of preferred stock dividend requirements during this period which, although shown as earned, were *not* paid and you get $51,970,575.[31] Presumably, if this amount truly represents undistributed earnings there should at December 31, 1941 be consolidated earned surplus of that amount. At that date, however, there was no consolidated earned surplus whatever. The balance of all surplus was precisely zero.

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[30] This is the estimated net income for 1942. Had the system not obtained the benefit of substantial non-recurring deductions for tax purposes in 1942, this figure would presumably have been much lower.

[31] Using estimated figures for 1942 the opinion arrived at "indicated undistributed consolidated earnings" of $51,525,951 for the fourteen years ended December 31, 1942.

At December 31, 1940, the balance was also precisely zero. And so, too, at the end of 1936, 1937, 1938, and 1939 the balance was likewise exactly zero.[32]

[fol. 69] Actually such "earnings" have been wiped out completely by charges carried directly to surplus.[33] The charges include debt discount, premium and expense written off ($12,807,659), intangibles and plant adjustments written off ($8,701,091); losses on sale of securities and properties including reductions in carrying value of investments ($8,552,647); street railway and other abandoned property written off ($2,739,997); appropriations to retirement reserve, largely in connection with abandonments or prospective abandonments of transportation properties ($7,133,612); and provisions for reserve for investments ($16,603,609). The miscellaneous credits to surplus include profit on sale of securities and properties ($4,982,-557) and gain on sale of reacquired stock ($4,106,736).

I also note that over $14,500,000 of the capital alleged to have been paid in by Power's common admittedly has disappeared. The amount claimed to have been paid in by Power's common is $28,482,745, the balance of common capital at April 30, 1942 is shown by Power's balance sheet to be $13,907,072, which leaves $14,575,673, as the amount which has been used up by various charges. It is difficult to determine precisely what happened to this $14,500,000 on a consolidated basis. The annual reports of the com-

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[32] This challenging and curious fact was due to following at the end of each year the highly questionable accounting practice of increasing the reserve for investments by an amount exactly equal to the excess of earnings over expenses and other charges. Moreover in 1941 and also in 1937 when expenses and charges happened to *exceed* earnings, sufficient amounts were transferred *from* such reserve for investments to the surplus account with the result that the deficit was eliminated and surplus remained at exactly zero. Clearly, the need or lack of need for a reserve for investments cannot be precisely dependent on whether there were net earnings or losses for the year.

[33] I do not pause to consider which of these charges should have been made to income and not to earned surplus. Most accountants will, I believe, agree that some of them, at least, should have been charged to income.

panies do not contain analyses of consolidated capital surplus for all years. Indeed, the consolidated financial statements of Railways and its subsidiaries contained in Power's 1942 report are not supported by a summary of consolidated earned surplus. I do know that substantial amounts in excess of the stated value of the common capital were credited to capital or paid-in surplus and that in 1936 a reserve for revaluation of investments of about $12,000,000 was provided out of capital or paid-in surplus. Since the reserve in Power's corporate balance sheet at April [fol. 70] 30, 1942 is less than $3,000,000, since there is no capital surplus shown and since the deficit in all surplus is stated to be $1,843,832, it is apparent that substantial losses have been charged off against paid-in capital.

The significance of these net direct charges of $66,000,000 may be tested in another way. If the preferred is permitted its right to cumulative dividends out of the indicated earnings, losses already charged off have been enough to wash out the entire common investment not once, but more than twice.[34]

I now proceed to the opinion's second table showing adjusted earnings for the years 1937-42. One of the principal troubles I have with this table relates to the nature of the adjustments made. The figures shown in Column 2 represent the annual balances of consolidated net income of Railways' system as constituted at April 30, 1942 applicable to Railways' common stock.[35] The consolidated net income of Railways is then adjusted for so-called "non-recurring" expenditures in the aggregate amount of $4,616,546 which has the effect of increasing the average annual net income by $769,425; from $5,415,120 to $6,184,545—which is rounded out at $6,185,000.

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[34] In addition there are substantial losses inherent in the remaining book assets for which provision had not been made at April 30, 1942. See supra p. 40, ff.

[35] For the 5 years from 1937 to 1941 these balances of Railways' income aggregate about $3,300,000 more than the actual consolidated net income of Power's entire system as shown in Column 1. I assume the difference is accounted for by the interest, expenses and taxes of Power which are not deducted. But is it proper to eliminate the entire amount of $3,300,000? I question whether all of Power's expenses can be so easily eliminated.

The $4,616,546 of so-called "non-recurring" expenses is composed of the following items:

Table II [36]

Amortization of:		
Gas conversion expenditures		$1,737,981
Holding companies' debt discount and expense		1,209,572
Plant acquisition adjustments		642,313
[fol. 71] Transportation property abandonments		510,000
Expenses of utility plant reclassification		455,797
Rate-case expenses		354,336
State commission appraisal and audit expenses		360,420
Installment payments to insurance company under annuity plan for past services of employees		646,527
Miscellaneous (nine items)		1,092,864
		$7,009,810
Deduct:		
Amount assigned to minority interest	$1,212,642	
Federal income tax adjustment	1,180,622	
		2,393,264
		$4,616,546

I question, as does the opinion, the propriety of eliminating these charges in total. However the opinion's assumed figure of $6,185,000 reflects their complete elimination. I concede that some of them may be truly non-recurring items. But common experience indicates that over a period of ten or fifteen years many so-called non-recurring expenses not possible of prediction will recur. Something should be included to cover these contingencies. Most people will agree, for example, that in a public utility sys-

[36] See opinion and Exhibit 14-28 of the Record.

tem as large as Railways, it is reasonable to expect rate-case expenses. Some companies in the system may be so subject at the present time as the opinion indicates. If this is the case, there is a question whether it may not be subject at least to the expenses of defending its rates.

[fol. 72] I note from Table II, *supra*, that $1,737,981 of gas conversion expenses are being eliminated. I also note that there are $1,285,000 of gas conversion expenses carried in the balance sheet as a deferred charge to be spread over future income accounts, and I understand that the management admits two companies may be forced to expend substantial amounts in changing over to natural gas.

Moreover, I have a further difficulty with this type of adjustment. It fails to give recognition to the important fact that both the company and regulatory authorities regard such extraordinary items of expense as appropriate charges against the revenues of the operating utilities. Accordingly, it is customary to allow for such items in the determination of fair and reasonable rates and by the same token to allow for their elimination when the amortization process is completed. If these assumptions are correct, it is entirely erroneous to adjust for gas conversion expenditures, expenses of utility plant reclassification, rate case expense, state commission appraisal and audit expenses, and possibly other items included under miscellaneous. Either such expenses will continue to be incurred or possible loss of revenues resulting from downward revisions of rate must be given consideration.

I note, also from the same table, charges during the period for debt discount and expense of holding companies in the amount of $1,209,572. I understand that these apply to Railways and Continental and are eliminated on the theory that the debt, or the companies, will eventually be out of the picture.

Let us analyze this adjustment. When the bonds in question were sold, bond discount and expense were set up because the proceeds were less than the face amount of the obligations issued. This difference represented in part the cost of issuing the bonds and in part an adjustment of the coupon rate. The real annual interest cost of the money obtained on the bonds is not interest at the coupon rate but instead that amount plus the pro-rata amount of the dis-

[fol. 73] count applicable to each year.[37] Should the debt be paid off prior to maturity,[38] any remaining balance of debt discount and expense must at that time be charged off, since at least the full face amount of the debt must be paid, unless I am to assume that the assets of those companies are insufficient to meet their debts. In forecasting earnings there is no more reason to eliminate amortization expenses of this character than there is to eliminate the coupon interest on the bonds.

From this same Table II and other sources, I note that there are certain charges added back to income which represent amortization of various items presumably once paid for in cash or its equivalent. They seem to be allowed as non-recurring charges on the ground that they were "charges for amortization which do not represent current cash expenditures or depreciation of properties." Illustrative of such charges are amortization of plant acquisition adjustments and street railway property abandonments. It is stated that the management urges that "while charges of this type, when made, constitute bookkeeping deductions against income available for dividends, the application of cash generated pursuant to such amortization programs results in no decrease in asset value, but rather improves the quality of the investment of security holders by transposing intangible items into tangible ones and enhances earnings."

This argument seems persuasive superficially, but does not stand up under scrutiny. I regard it as indefensible at least so far as it deals with plant acquisition adjustments.

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[37] This Commission has so held in several cases: see *In the Matter of Alleghany Corporation*, 6 S. E. C. 960 (1940); *In the Matter of Associated Gas and Electric Co.* — S. E. C. — (1942) (Securities Exchange Act Release No. 3285A).

[38] I assume here the debt is not refunded. Where the debt is refunded, authority may be found for charging off the old discount at once or for carrying the old discount forward and amortizing it over the life of the refunding issue or over the remaining life of the refunded issue. I have discussed these varying views in an article, "Treatment of Debt Discount and Premiums upon Refunding," which appears in Vol. 73, Journal of Accountancy, at p. 199 (1942).

Such adjustment items are admittedly a part of the cost of [fol. 74] property—the excess over original cost. The amortization thereof is not essentially different from depreciation. This cost should be matched against revenues and it is just as improper to exclude it as it would be to exclude depreciation. Such a theory would permit the showing of excellent revenues by excluding the cost of producing them.

It will be noted from my Table II that $1,180,622 is included as an adjustment for increase of Federal income taxes. I will try to demonstrate how unrealistic this adjustment is in the light of present, and even past, tax rates. The adjustment is based on the premise that if non-recurring expenses are eliminated, taxable income and taxes will be increased. I agree. The amount of $1,180,622, however, includes $681,622 for increased Federal income taxes estimated to result from the elimination of Power. This amount is entirely unrelated to whatever adjustment of taxes should be made with respect to the management's suggested elimination of $7,009,810 of "non-recurring" expenses. I, therefore, deduct $681,622 from $1,180,622. The remainder, $499,000, presumably is to take care of the increased Federal income taxes estimated to result from the elimination of so-called "non-recurring" charges from the balance of income applicable to the common stock of Railways. These charges from 1937 to 1942 totalled $5,797,168 (being the $7,009,810 shown in Table II, less the $1,212,642 assigned to the minority interest). The amount of $499,000 is less than 9% of $5,797,168. For 1942, the sum of the normal and surtax rates for companies filing on a consolidated basis is 42%. But, a 9% tax rate as an allowance for taxes payable on an assumed increase in income is unreasonably low.

What is even more difficult for me to overlook is the failure to guage the extent of the adjustment necessary to reflect a realistic level of Federal income taxes in determining the earnings figure of $6,185,000. The system's past taxes doubtless have been low relative to reported earnings and income because the system practice of charging [fol. 75] many losses directly to capital or earned surplus. Since 1928 such losses have amounted to over $66,000,000. I suspect, however, that a substantial portion of such losses were deductible from income for tax purposes and so sub-

stantially reduced the system's income taxes. Certainly, in determining "earning power," these "non-recurring" tax deductions are of vital significance, and I am convinced that the "assumed earnings" figure of $6,185,000 should be adjusted downward to give effect to them.[38a]

My difficulties with the question of taxes in their relation to earnings do not stop here. As indicated by Power's 1942 annual report the income for that year of Power and its subsidiaries, except Kansas City Power and Light Company and San Antonio Public Service Company, will be included in the consolidated Federal income and excess profits tax returns to be filed by Power and by Traction respectively.[39] Power reports that no excess profits taxes were incurred by any of the companies included in the consolidated returns for 1941, and for the year 1942 there will be no liability for excess profits taxes because Power and Traction each had excess profits credit carry-overs from 1941.

Power's annual report calls attention to three significant facts with respect to the system's 1942 tax returns. The first is that the excess profits credits are subject to review by the Treasury Department. Such review may develop that Traction will have no substantial excess profits credit carry-over to 1943. The second is that while Power will have a substantial carry-over to 1943, the benefit of this carry-over will not be available for periods after its final liquidation has begun, which probably will occur in 1943. The third point is that the tax liability of the companies included in the consolidated return of Power was $546,000 [fol. 76] less for the year 1942 than it was for 1941 because

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[38a] I realize that future taxes of the system may also be reduced by deductions of items similar to those I have discussed. However, in such case, not only taxes but also income or earned surplus would be reduced.

[39] The Revenue Act of 1942 permits the filing of consolidated Federal income and excess profits tax returns by companies affiliated under certain conditions of stock ownership. Under the Revenue Act of 1941, a consolidated Federal tax return could be filed only with respect to excess profits taxes.

these companies had the benefit in 1942 of substantial tax deductions for interest and debt discount and expense of Power relating to its debentures which became payable on May 1, 1942. These deductions will not recur in 1943.

The same annual report of Power states that the reported total consolidated income taxes of Railways and its tax affiliated subsidiaries for the year 1942 are approximately $4,540,000 less than would be payable if separate tax returns were required to be filed by Railways and each of its subsidiaries.

These facts are significant. They indicate first that in 1942 there were substantial non-recurring deductions which served to reduce taxes and to increase the income applicable to Power's securities. They also indicate that the system earnings for 1942 were substantially affected by large "savings" resulting from the filing of consolidated income tax returns. I agree with the majority opinion that it is impossible to predict whether the privilege of filing consolidated tax returns will be withdrawn or modified. I point out that it is also impossible to predict the aggregate effect on taxes of the dissolution of Power, the indicated reorganization of Railways on undefined terms, and the elimination of Traction upon conditions not now known. These facts emphasize the uncertain nature of the earnings which the opinion assumes for the purpose of determining the rights of the preferred and common stocks.

I next turn to the extreme leverage position of the $6,185,000 of earnings assumed by the majority as being applicable to the common stock of Railways. On the basis of Railways' consolidated net income for the year 1941, adjusted to give effect to the system as constituted at April 30, 1942, the balance of consolidated net income applicable to Railways' common was $4,906,879. I have summarized from this consolidated income account a statement, beginning with the net earnings of the operating subsidiaries, to show the numerous and substantial claims against such net [fol. 77] earnings which must be satisfied before there is anything left for the common. For reasons stated above I have not made any adjustments for so-called non-recurring charges. I might add that the $22,300,000 figure with which I begin represents what is left of $100,900,000 of gross

operating revenues after deducting operating expenses and taxes and adding other income. The statement to which I refer follows:

Condensed Pro Forma Consolidated Net Income of Railways and Its Subsidiaries Applicable to Railways' Common Stock for the year Ended December 31, 1941

	Amount	Percent
Net earnings of operating subsidiaries	$22,285,885	100.0
Interest and dividends on securities held by the public, etc.	8,755,222	39.3
Balance	$13,530,663	60.7
Subsidiary holding and investment companies—		
Interest and dividend revenues	1,768,042*	7.9*
Expenses, interest and taxes, etc.	935,133	4.2
Interest on long term debt	2,631,253	11.8
Dividends on preferred stocks	1,279,528	5.7
Minority interest	2,296,764	10.3
	$5,374,636	24.1
Balance	$8,156,027	36.6
[fol. 78] Railways—		
Interest and dividends	30,597*	0.1*
Expenses and taxes, etc.	731,862	3.3
Interest on debentures	1,352,624	6.0
	$2,053,289	9.2
Consolidated net income	$6,102,738	27.4
Dividends on preferred stock of Railways	1,195,859	5.4
Balance applicable to the common stock of Railways	$4,906,879	22.0

* Denotes red items.

It is painfully apparent that the assets and earnings applicable to Railway's common stock are at the bottom of a highly attenuated pyramid. The balance of $4,907,000 is the remnants of a $22,300,000 original stream of net earnings of operating utilities. It reaches Railways' common only after being strained through large amounts of senior securities of the operating companies, through Continental and Traction, each of which has considerable amounts of publicly held senior securities and through the senior securities of Railways itself.[39a] It is in short what would be available to Railways common if every dollar of applicable earnings were drawn up from every child and grandchild in the system. It will be noted that the balance of consolidated net income applicable to the Railways common is only 22% of the operating subsidiaries' net earnings and it is less than 5% of the gross operating revenues of the subsidiaries. To me this balance of income is exceptionally tenuous for in 1941 a 7% increase in operating expenses [fol. 79] and taxes would have left nothing for Railways' common therefore nothing for anyone in Power. These facts, the distance from the source of earnings and the size of senior claims, speak more eloquently than the optimistic predictions of earnings made by the management and the estimates of earnings used by the opinion.

IV

The opinion does not agree that the rights of the preferred and the common should be judged by counting the preferred at its liquidating value including arrearages. Nor does it agree that they should be judged by comparing that sum either with the book value of the enterprise as reflected in the corporate and consolidated statements of Power or Railways, or with a valuation reached by capitalizing reasonably expected earnings at a rate that reflects

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[39a] Since its inception the system has had excessive senior securities. For example, one of the subholding companies, Continental Gas and Electric Company, has outstanding $49,500,000 of 5% debentures owned by the public, and more than $11,000,000 of 7% prior preferred stock also owned by the public.

the degree of risk attending the actual realization of those earnings and attending the investment of the capital needed to produce those earnings. In fact the opinion recognizes that on no reasonable basis of capitalizing the estimated earnings will there result a valuation large enough to satisfy the face amount of the preferred's claims.

Instead, what the opinion sets out to do is to measure the respective rights of the preferred and common stocks "not in terms of the situation created by the statute but rather in terms of the situation terminated by it—i.e., as though no liquidation were to take place". To this I reply that if no liquidation is taking place and if the respective rights are not to be determined in terms of the situation created by the statute, it is difficult for me to see any basis for refusing to recognize the present rights of the preferred or indeed for changing them at all. The opinion, however, proposes to measure these rights by examining "into the respective existing interests of the preferred and common stockholders in the earnings of the enterprise", with the purpose of determining whether the assumptions necessary [fol. 80] to arrive at a proposed allocation of assets "fall within the permissible limits of reasonableness". For this purpose, the opinion assumes annual earnings of $6,185,000.[46]

The opinion, however, does not undertake to determine a proper rate of capitalization of these earnings as a basis for determining the value of the enterprise. In fact it does not value the enterprise at all. What it does is to calculate that if dividends are kept current on the preferred stock it will take about 15 years to pay off the arrearages of $38,700,000. This is on the impracticable assumption, which experience belies as the opinion concedes, that all the earnings of subsidiaries applicable to Power can and will be paid to Power and that Power will apply them to the payment of accumulated and current preferred dividends.

Although the opinion states that the possibility of the

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[46] I have already commented at length upon the opinion's analysis and conclusions as to the earnings history, and future, of Railways. My criticisms apply with equal weight to the propriety of this assumption.

common sharing in the earnings is "remote", nevertheless the opinion permits a 5% but not an 8.8% participation to Power's common stockholders. It is true that the majority's conclusion is stated to be "of necessity one of over-all judgment and not susceptible of mathematical demonstration." But to me there is implicit in reducing an 8.8% participation to about 5% a precision or reliance on something that is not justified by what appears in the opinion or indeed by the facts. The opinion says that "as the participation of the common stock approaches zero it is giving up for the benefit of the preferred stock nearly 100% of its chance of participating in any future earnings in excess of the existing preferences of the preferred. On the other hand, if earnings do not equal such preferences, the preferred stock gives up but approximately 5% of the earnings actually realized." This is literally true, looking at it from one side of the picture. I would prefer to state it in another way. As I see it, Power's common stock relinquishes 95% of nothing in return for 5% of whatever Railways' common may earn.

[fol. 81] The preferred stock having a stated, liquidating, and paid-in value of $60,000,000 with arrearages of $38,700,000 as of December 31, 1942 is asked to accept for its claim 95% of the common stock of Railways. Although the entire common stock of Railways has at its indefensible best a book value of not to exceed $81,554,330 and an optimistically estimated earning power of $6,185,000, the Power common is assigned 5% of this stock carrying a book value of $4,077,716 and a pro rata share in estimated annual earnings of $309,250. Yet the opinion seems to regard the allotment of all of Railways' common to the preferred as "enriching" the preferred at the expense of the common—despite the fact that this book value, admittedly greater than its present value, falls more than $14,000,000 short of equalling the preferred's claims. This is a strange enrichment, especially when we consider that the preferred received no dividends during the long period in which it is claimed the system's assets were being built up through retaining earnings, and when we consider that the preferred which contributed at least two-thirds of the stock investment has received only 55% of the dividends actually paid while

ine common, contributing one-third of the stock investment has received about 45% of the dividends actually paid.[41] [fol. 82] The opinion neglects to value the enterprise. The approach by the majority can be compared with that implicit in which Justice Reed said in the recent *Western Pacific Railroad* case:[42] "It is obvious that the valuation of the whole of a debtor's property, in a simple case without conflicting or divisional liens, will mark, by a mere mathe-

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[41] The dividend history may be summarized briefly in this way:

Amount contributed:	Common-Stock	Preferred Stock
Cash	$17,121,000	$60,000,000
Other	11,361,745	—
Total	$28,482,745	$60,000,000
Dividends paid	$ 8,752,796	$10,538,118
Dividends per $100 of recorded capital	$30.73	$17.56

In other words, the preferred stock which contributed at least two-thirds of the stock investment (nearly 80% of the cash) received only about 55% of total dividends paid since issuance. The common stock, junior to the preferred as to dividends, contributed less than one-third of the stock investment but received somewhat more than 45% of total dividends paid. The common has received dividends amounting to nearly 31% of its investment (51% of the cash invested) while the preferred's dividends amount to but about 17½% of its investment or less than 1¼% a year. And despite the opinion's finding of "indicated consolidated earnings" of over $51,000,000 since 1932 only one three months' dividend amounting to $900,000 has been paid the preferred since dividends on the common stock were discontinued in 1931. To me, this earnings and dividend history is not to be overlooked in considering whether the proposed 5% participation by Power's common stock is, in fact, "fair and equitable."

[42] *Ecker v. Western Pacific* R. R., — U. S. — (March 15, 1943).

matical computation as to priorities, the claimants who must be found to be without equity in whole or in part."

However, my principal objections to the way the majority reaches its conclusions go deeper than any I have mentioned. If their conclusion resulted from applying the proposition that earnings actual, and reasonably to be expected, are to be capitalized at an appropriate rate for the purpose of determining whether there exists a value for the Railways' common over and above the liquidating value (which includes arrearages) of Power's preferred, and therefore whether Power's common should participate, I would agree with them. In the *Consolidated Rock* case the Supreme Court said that "the value of the assets of the enterprise must be ascertained in order to determine the appropriate allocation of securities among the old security holders." But it is apparent that no such reasoning was followed in the opinion. It is clear from the whole opinion that controlling weight was given to preferred's rights to earnings.[43]

[fol. 83] We are not dealing here with that type of preferred stock which has a preference merely as to earnings. If the majority's theory and not the liquidation theory is to prevail the fair and equitable method seems to me to be to determine first of all whether the preferred is being fully compensated for what it surrenders and then, if anything

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[43] That such is the position appears from the following statements which I will quote verbatim:

(1) "The assets of Power are, in our opinion, of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942."

(2) "In the light of all the circumstances, we conclude that on no reasonable basis for capitalizing prospective earning power could we arrive at a valuation equal to the liquidation preference."

(3) "If the amount of the liquidation preference of the preferred stock ($100 per share plus accumulated dividends) is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common."

remains, to give it to the common. This is consistent with the contracts of the two classes of stockholders. It is what the priorities and the rights of the parties require. It is not proper or fair or equitable to determine first what the common should have and give what is left to the preferred. It is not proper to determine whether at some remote day the common may expect some earnings and fail to determine whether the preferred is being fully compensated.

The basis of the preferred right is not its value. It is its contract. That basis includes its prior claim on earnings, its right to accumulate unpaid dividends, its right to receive $105 a share and arrearages in case of redemption, its present arrearages, and also its right to be paid $100 a share plus arrearages (even if the use of capital be necessary) before the common gets anything in case the corporation is liquidated or dissolved. All those rights are being cancelled. The preferred is entitled to full compensation therefor before anything goes to the common. But it is not receiving an amount equal to its present claim, to say nothing of additional compensation for relinquishing its preferences as against Power's common stock. Its claim is $98,700,000 as of December 31, 1942. The book value of the securities it will receive is about $77,100,000 (before the adjustments I have previously noted) and it must not be forgotten that these new shares will govern not only the preferred's future participation in earnings but will measure its distributive share of the assets if liquidation of Railways ever occurs or if Railways is reorganized as the majority opinion [fol. 84] suggests it might have to be. The common stock is allowed to participate in Railways' common to the extent of 173,838 shares having a total par value of $1,216,866 and a total book value of $4,450,000. Upon liquidation of Power, the preferred is entitled to 100 cents of every dollar until it receives $164.50 per share before the common gets anything. Under the plan if Railway liquidates, Power's preferred gets only 94.52 cents of every dollar and the old common gets 5.48 cents.[44] Before the plan Power's preferred was entitled to $6 per share per annum from earnings cumulatively before Power common got anything. Under the

[44] These amounts are based on the actual plan as approved in the supplementary Findings and Opinion. It will be noted that the share allotted the common is roughly 10% greater than the 5% arrived at in the opinion.

plan it shares the earnings with Power's common in the proportion of 95% and 5%.

The opinion seems to regard Power preferred's prior claim on assets for $100 per share (plus arrearages) in liquidation as worthless and as not entitling it to priority now. This I regard as unfair and inequitable, both legally and colloquially.

The opinion seems to admit that Power's preferred stock has senior rights, but it does not seem to realize that those senior rights include not only a prior claim on earnings but also on assets when a liquidation occurs. Liquidation was not in immediate prospect when the corporation was organized and yet the charter provided that *if* it should be liquidated the preferred was to be paid in full for liquidating value and arrearages of dividends before the common was paid anything. That right is not recognized and is being taken away. It is true that this liquidation may not be the fault of the common stockholders. It certainly is not the fault of the preferred.

The opinion seems to me to ignore the fact that the preferred, in consideration of accepting a limited dividend participation, was given a superior claim on assets, if liquidation occurred, and on earnings and the right to accumulate unpaid dividends and the right to receive $105 a [fol. 85] share plus arrearages in case of redemption. The majority opinion states: "The limitation of the preferred stock's dividend to a fixed amount is a valuable right vested in the common stock." I agree. What the opinion neglects is that the prior claim of the preferred to assets as to both liquidation value and arrearages is a valuable right vested in the preferred. The preferred got that right by accepting the limited return which the majority says is a valuable right vested in the common. In arriving at the preferred's participation, to give controlling weight to its limited dividend right at the expense of the concomitant and compensating claim on assets seems wholly wrong. It is directly at odds with these contracts and underlying considerations and most unfair. It is respecting only one part of the bargain.

The opinion seems to claim the preferred has no right to the immediate receipt of dividends. I differ. Upon liquidation the preferred is entitled to accumulated dividends if there are sufficient as-ets to pay them.[45] The majority point

[45] See footnote 3, *supra*.

of view seems inequitable in view of the fact that from 1932 to 1943 no dividends were paid to the preferred but were allowed to accumulate, even though, as the opinion states, there were consolidated earnings of $51,525,951.[46] The cash generated by these earnings was reinvested in the enterprise and in an important degree was used to liquidate indebtedness or to build additional property now included in the asset accounts of the companies. The use, thereof, built up the asset and earnings position of the system in a way which would ordinarily add to the equity of the common stock of Power which controlled the system. This resembles capital for the use of which nothing is paid and when it is proposed not to fully compensate the preferred for the use thereof but in liquidation (or reorganization) to fail to compensate it in full for the cancellation of its [fol. 86] accumualted unpaid dividends, the proposal is eloquent as to its own inequity. (Parenthetically I note that despite the use of these earnings the system has not been able to build an asset or earnings position which affords a valid basis for the old common's participation.)

I am emphatically opposed to any liquidation or reorganization that sacrifices or fails to recognize legitimate values. In case of doubt I would prefer to err, if at all, on the side of optimism. But the legitimate value of Railways' common falls so far short of the claims of Power's preferred that it isn't even close. Indeed it is my conviction that the common's investment in Power was lost years ago, before the passage of the Holding Company Act. I am happy to say that the system's future seems much brighter than the past. The elimination of burdensome and superflous companies, the simplification of others, the concomitant reduction in costs are all to the good and I recognize the careful conduct of the company's affairs by the present management. The plain and unfortunate fact, however, is that this company was handicapped from birth by congenital defects and deformities and picked up a few more thereafter; it was over-capitalized; it was over-pyramided; it paid excessive prices for property; it indulged in dubious accounting. Its whole financial structure was "jerry built"

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[46] I have shown above that direct charges to surplus have absorbed these earnings. However, for present purposes only, I will accept the majority's statement.

and was of the weakest and most dangerous character. The investors in Power have reaped the whirlwind of winds sowed some years ago by reckless promoters.

April 1, 1943.

[fol. 87] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

SUPPLEMENTAL FINDINGS AND OPINION—April 5, 1943

In our Findings and Opinion herein we pointed out that our approval of the plan for the dissolution of The United Light and Power Company would be withheld unless such plan was amended to provide that the participation of the common stockholders of Power should not exceed approximately 5%. On April 2, 1943 the applicants filed a document in which they accept and adopt the modifications of the plan referred to in said Findings and Opinion of the Commission and in which they request the Commission to take appropriate action to enforce the plan as so modified, pursuant to the provisions of Section 11 (e) of the Act.

The plan as now amended provides for the exchange of 5 shares of Railways' common stock for one share of Power's preferred and one share of Railways' common stock for 20 shares of Power's common, an allocation of 94.52% to Power's preferred stockholders and 5.48% to Power's common stockholders. Under the amended plan the common stock of Railways will have a par value of $7 per share instead of $6 as originally proposed. The aggregate par value of Railways' new common stock to be outstanding upon consummation of the plan as amended, will be $22,216,866, resulting in a reduction in the capital by an amount of $2,581,334 which will be transferred to the paid-in surplus account of Railways.

For the reasons set out in our Findings and Opinion in this matter, an appropriate order will issue approving the amended plan, subject, however, to the several conditions and reservations of jurisdiction noted in such Findings and Opinion. Furthermore, the request of the applicants that we apply to an appropriate Federal court to enforce and carry out the terms and conditions of the plan as approved is granted by the Commission.

[fol. 88] By the Commission (Chairman Purcell and Commissioners Pike, Burke and O'Brien), Commissioner Healy dissenting for the reasons set forth in his opinion of April 1, 1943.

Orval L. DuBois, Secretary. (Seal.)

April 5, 1943.

[fol. 89] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

ORDER GRANTING APPLICATION NO. 14 AS AMENDED

The Commission having directed, by an order entered in this proceeding on March 20, 1941, pursuant to Section 11 (b) (2) of the Public Utility Holding Company Act of 1935, that The United Light and Power Company be liquidated and dissolved and that said company make application to the Commission for the entry of any further orders necessary or appropriate for such purpose;

Said order having further provided that said company might submit to the Commission for its approval a plan proposing a method for complying with said order, on a basis which should be fair and equitable to its security holders, and providing for a determination of the relative rights and interests of its security holders in connection therewith;

The Commission having expressly reserved in said order jurisdiction to enter such further orders in this proceeding as may be necessary or appropriate for the purpose of carrying out the steps required by said order;

The United Light and Power Company, a Maryland Corporation, and its subsidiary, The United Light and Railways Company, a Delaware Corporation, both of which are registered holding companies, having filed a joint application (designated as Application No. 14), pursuant to Sections 11 (b) and 11 (e) of the Public Utility Holding Company Act of 1935 and the requirements of said order of March 20, 1941, proposing a plan for the completion of the liquidation and dissolution of The United Light and Power Company and providing, among other things, for the contribution of cash and minor investments by The United Light and Power Company to The United Light and Railways Company, the distribution by The United

Light and Power Company of the remaining asset consisting of all outstanding common stock of The United Light [fol. 90] and Railways Company among the preferred and common stockholders of The United Light and Power Company and for a determination of the manner and the basis of such distribution;

A public hearing on said Application No. 14 having been held pursuant to appropriate notice at which the applicants and all their security holders and other interested persons were given an opportunity to be heard, and the Commission, on the basis of the record, having made and filed its Findings and Opinion dated April 1, 1943, proposing certain modifications to said plan and finding that the plan if modified in accordance with said Findings and Opinion would be fair and equitable to the persons affected thereby and necessary to effectuate the purposes of Section 11 (b) of the Act; and

A document having been filed in this proceeding on April 2, 1943 in which the applicants accept and adopt the modifications of the plan referred to in said Findings and Opinion of the Commission, and in which the applicants request the Commission to take appropriate action to enforce the plan as so modified, pursuant to the provisions of Section 11 (e) of the Act;

The Commission now finds, on the basis of its Findings and Opinion herein dated April 1, 1943, and its Supplemental Findings and Opinion dated April 5, 1943, that the plan as modified by the applicants is fair and equitable to the persons affected thereby and is necessary to effectuate the provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935, and should be approved subject to the conditions hereinafter enumerated.

The United Light and Power Company, pursuant to the provisions of Section 11 (e) of the Act, having requested the Commission to apply to an appropriate Federal Court, in accordance with the provisions of subsection (f) of Section 18 of the Act to enforce and carry out the terms and provisions of the plan as modified;

[fol. 91] It is hereby ordered, pursuant to Section 11 of the Act and particularly subsections (b) and (e) thereof, and pursuant to all other applicable Sections of the Act, that the plan set forth in Application No. 14 as modified be and the same is hereby approved; said approval by the

Commission shall not, however, be operative to authorize the consummation of transactions therein proposed until an appropriate federal district court shall upon application thereto enter an order enforcing the plan.

It is further ordered that the accounting entries submitted by the applicants necessitated by the various transactions comprising the plan as modified are approved under the applicable Sections of the Act, and the Rules thereunder.

It is further ordered that, in carrying out paragraph 11 of the plan as modified, The United Light and Railways Company shall, upon its acquisition of the securities of Mason City and Clear Lake Railroad Company and La Porte Gas and Electric Company, be bound by the orders of this Commission directing The United Light and Power Company to divest itself of its interest in said companies.

It is further ordered that the issues, transfers and exchanges of securities specified and itemized below are necessary and appropriate to effectuate the provisions of Section 11 (b) of the Public Utility Holding Company of 1935, 49 Stat. 820 (U. S. C., Title 15 Sec. 79k (b)):

(a) The issuance by The United Light and Railways Company of 3,173,838 shares of new $7 par value common stock and the exchange thereof for its outstanding 708,520 shares of $35 par value common stock in accordance with the plan as modified.

(b) The delivery of said 3,173,838 shares of common stock of The United Light and Railways Company by The United Light and Power Company to a depositary for distribution to the preferred and common stock-[fol. 92] holders of The United Light and Power Company in accordance with the plan as modified.

(c) The transfer of not exceeding 3,173,838 shares of $7 par value common stock of The United Light and Railways Company in exchange for outstanding preferred and common stocks of The United Light and Power Company or in exchange for scrip of The United Light and Railways Company in accordance with the plan as modified.

(d) The surrender of 600,000 shares of $6 cumulative preferred stock, 2,421,192 shares of Class A common stock and 1,055,576 shares of Class B common

stock of The United Light and Power Company in exchange for shares of $7 par value common stock or scrip of The United Light and Railways Company in accordance with the plan as modified.

(e) The issuance, transfer and exchange of scrip of The United Light and Railways Company and the issuance or transfer of $7 par value common stock of said Company in exchange therefor to the extent necessary to carry out the plan as modified.

(f) All other transfers and exchanges of common stock and scrip of The United Light and Railways Company which are required in order to carry out the plan as modified.

(g) The transfer by The United Light and Power Company to The United Light and Railways Company of $324,000 principal amount of First Refunding Mortgage 6% bonds, due June 1, 1932 and 100 shares of no par value capital stock of Mason City and Clear Lake Railroad Company, and 7,500 shares of $100 par value capital stock of La Porte Gas and Electric Company in carrying out the provisions of paragraph 11 of the plan as modified.

[fol. 93] This paragraph is included in view of Section 1808 (f) of the Internal Revenue Code and is intended to cover all issues, transfers and exchanges of common stock and scrip of The United Light and Railways Company to preferred and common stockholders of The United Light and Power Company and all other transfers of securities which are required in order to consummate the plan.

It is further ordered that pending final determination of the amounts, upon consummation of the plan as modified and completion of the record, the Commission reserves jurisdiction to pass upon the reasonableness of all counsel fees.

It is further ordered that counsel for the Commission be, and they are hereby authorized and directed to make application forthwith on behalf of the Commission to an appropriate Federal Court to enforce and carry out the terms and provisions of the plan as modified, pursuant to the provisions of Section 11 (e) of the Act and in accordance

with the provisions of subsection (f) of Section 18 thereof and the request duly filed herein by The United Light and Power Company.

It is further ordered that The United Light and Power Company shall mail to its stockholders of record a copy of the Findings and Opinion entered herein, together with a copy of this Order, and shall give notice of the date set by the Court for hearings on said application by mailing to such stockholders a copy of such Notice of Hearing as the Court may direct.

It is further ordered that within 30 days after the distribution date defined in the plan as modified the applicants shall file a Certificate of Notification advising the Commission of the steps which have been taken to consummate the plan.

By the Commission.

Orval L. DuBois, Secretary. (Seal.)

[fol. 94] In the United States District Court, District of Delaware

Opinion—July 30, 1943

John F. Davis, solicitor, Roger S. Foster, counsel, Robert M. Blair-Smith, executive assistant, John W. Christensen, for the Securities and Exchange Commission.

Donald R. Richberg (Davies, Richberg, Beebe, Busick & Richardson) of Washington, D. C. John Dern (Sidley, McPherson, Austin & Burgess), of Chicago, Ill., and Clarence A. Southerland (Southerland, Berl & Potter) of Wilmington, Del., for The United Light and Power Company.

Richard B. Hand of New York, N. Y., and Arthur G. Logan (Logan & Duffy) of Wilmington, Del., for Otis & Co., Intervener.

Townsend, Elliott & Munson, of Philadelphia, Pa., for a Committee of Preferred Stockholders of The Commonwealth & Southern Corporation, *amicus curiae*.

Leahy, District Judge:

This matter is here on an application of the Securities and Exchange Commission pursuant to Section 11 (e) and

18 (f) of the Public Utility Holding Company Act of 1935 [1] "to enforce and carry out the terms and provisions of" a plan of action by The United Light and Power Company for the purpose of enabling Power to comply with the provisions of Section 11 (b) of the Act. This court's jurisdiction is based on the fact that Power transacts a substantial portion of its corporate business in this district and thus comes within Sections 18 (f) and 25.

The amended plan designed to effectuate the dissolution of Power in accordance with the Commission's order of March 20, 1941, was approved by the Commission on April 5, 1943. It provides in substance for the contribution of cash and certain investments of Power to its subsidiary, [fol. 95] The United Light and Railways Company, for the reclassification of the preferred and common stocks of Power into a single class of new common stock by way of the distribution of all the common stock of Railways in the ratio of 94.52% to Powers preferred stockholders, and 5.48% to its common stockholders, the assumption of Power's liabilities by Railways, the transfer of Power's remaining assets to Railways, and, finally, the formal dissolution of Power. The distribution to the common stockholders of Power approved by the Commission is less than was originally proposed by the management of Power, who had suggested an 8.8% allocation to Power's present common stockholders. This distribution of a portion of the equity to the old common stock of Power caused one Commissioner [2] to dissent vigorously. Otis & Company, owner of 10 preferred shares, seeks to intervene and objects to approval of the plan, while a committee for the preferred shareholders of the Commonwealth & Southern Corpora-

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[1] In this opinion I refer to the Securities and Exchange Commission as the "Commission"; to United Light and Power Company as "Power"; to United Light and Railways Company as "Railways", and to the Public Utility Holding Company Act of 1935, 15 U. S. C. A. § 79 as the "Act".

[2] Commissioner Healy filed an elaborate dissenting opinion. The position of the intervenor, Otis & Co., is based largely—if not wholly—upon the arguments advanced in that opinion.

tion, a stranger to these proceedings, filed a brief as *amicus curiae* in opposition to the plan.

Under the amended plan, Railways' authorized common of 1,000,000 shares with a par of $35—all owned by Power—will be increased to 3,500,000 with a par of $7 each share to have one vote. The outstanding 708,520 shares of Railways' common will then be exchanged by Power for 3,173,838 shares of Railways' new stock. The change in par value of Railways' common will reduce the amount of capital from $24,798,200 to $22,216,866, and the difference of $2,581,334 will be credited to Railways' paid-in surplus account.

The objections to the plan raise no issues of fact. The objections merely endorse the views of Commissioner Healy who broke from the majority of the Commission on an issue of law. That issue will be discussed shortly.

[fol. 96] I. Intervention. Otis & Co. once acted as an underwriter for the preferred stock and presently owns 10 shares. The Commission thinks it appropriate to permit Otis & Co. to be heard on their objections to the plan on the ground that Sec. 11 (e) entitles a security holder to have his objections considered by the district court. Power objects to intervention because notice was given on April 21, 1943, under order of this court that the hearing on the plan would occur on June 15, 1943, and any persons who opposed approval and enforcement were required to file their objections on counsel for the Commission and Power on or before June 1, 1943. This, Otis & Co. failed to do. And Power further claims that no excuse for such default or delay has been presented, although Otis & Co. has had knowledge of the proceedings before the Commission for some years. Moreover, Power points out that at no time did Otis & Co. appear in the proceedings before the Commission. Accordingly, Power argues that Otis & Co. should have utilized the opportunity for administrative relief before appealing for judicial relief to correct an error of law on the Commission's part. Finally, Power contends that Otis & Co. should have sought review of the Commission's order of April 5, 1943, in a circuit court of appeals under Sec. 24 (a), which provision requires a party who wishes to exercise his right of appeal to show he is a "party aggrieved" and limits his objections to those urged before the Commission.

I think it may fairly be argued that the appeal provided by Sec. 24 (a) and an opportunity to be held before the district court under Sec. 11 (e) with the concomitant right to appeal under Sec. 25 to, as here, the Third Circuit Court of Appeals, from the District Court's finding, are alternative rights of appeal.

Otis & Co. relies wholly on the ultimate issue of law which split the Commission; and that was a substantial issue of law which must be determined regardless of whether Otis & Co. is in or out of these proceedings. Whether this court [fol. 97] should demand strict compliance with its order of April 16, 1943, and refuse to hear a party who failed to file his objections by June 1, 1943, is obviously a matter resting in the discretion of the court. In this case, I think the exercise of discretion should be in favor of Otis & Co.

Procedural analogies on the right of stockholders to be heard and to appeal in 77 B and Chapter I proceedings in bankruptcy offer some help;[3] but I hardly think them applicable here. In my view, I think Sec. 11 (e) of the Act supports Otis & Co.'s right to intervene, file its proposed answer—containing its objections to the plan—and be heard. In fact, all this is a fait accompli, as I have already heard Otis & Co. at length. Its right to appeal is a matter which does not have my immediate concern. That is a matter which the circuit court may some day be called upon to answer.

II. The Plan. We have merely two issues: (a) is the plan "appropriate to effectuate the provisions of Sec. 11"; and (b) is the plan "fair and equitable."

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[3] Under Sec. 77 B and Chapter X of the Bankruptcy Act, the right to appeal is tantamount to this statutory right to be heard. In re Day & Meyer, Murray & Young, Inc., 2nd cir., 93 F. 2d 657; In re Barday Park Corp., 2nd cir., 90 F. 2d 595. Creditors at one time had a limited right to be heard. Tetzke v. Trust No. 2988 of Foreman Trust and Savings Bank, 7th cir., 85 F. 2d 942, cert. den. 299 U. S. 609. Chapter X enlarged the rights of both creditors and stockholders to be heard. In re Philadelphia & Reading Coal & Iron Co., 3rd Cir., 105 F 2nd 358; Keystone Realty Holding Co., 3rd cir., 117 F. 2d 1003; and Dana v. Securities and Exchange Commission, 2nd Cir., 125 F. 2d 542. The right to be heard and appeal, therefore, would seem to obviate formal intervention in bankruptcy.

(a) Power is the apex holding company at the top of a pyramid system. There are subholding companies between Power and the base. One of the principal of these is Railways. The common stock of Railways and cash constitute Power's assets. Railways own the securities representing Power's interest and control in the lower companies. Power will eliminate its stock liability through a distribution of its assets in kind, a method, the Commis- [fol. 98] sion has found, which will be both economical and appropriate to effect compliance with Sec. 11 (b).

Prior to the entry of its order of dissolution on March 20, 1941, extensive hearings were had. No appeal was taken from the order, and the time for seeking a judicial review has long since expired. Really the question of necessity for the plan is no longer with us; and critical re-examination of such question is, I think properly, beyond my judicial ken. However, it is clear that the plan is "appropriate to effectuate the provisions of Sec. 11." After review, I accept the findings of the Commission that there is necessity for the plan and for Power to liquidate pursuant to Sec. 11 (b) (2).

(b) Is the plan fair and equitable? The charter of Power provides, inter alia, that "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the Class A Preferred stock shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of such stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned) including the full dividends for the then current quarterly period, before any payment is made to the holders of any stock other than the Class A Preferred stock in accordance with their rights at the time of distribution." Admittedly, preferred has a principal claim of $60,000,000 and an accumulated dividend charge of $38,700,000. If the dividend claim is capitalized as a matured obligation, the total claim of preferred will be $98,700,000. All parties agree also that the assets represented by the common stock of Railways have not a present value equal to that amount. If the contractual preferences are operative it is clear there will be nothing for the common shareholders.

The problem for determination is whether the plan is "fair and equitable." Concededly, the plan does not sat- [fol. 99] isfy the "absolute priority" rule which is applied in equity and bankruptcy reorganizations.[4] Under that rule, no plan can be fair and equitable which permits a junior security to retain an interest in the reorganized corporate enterprise before the securities senior to it have been paid in full (but not necessarily in cash) for the rights which they surrender. The value of the reorganized concern is projectively determined by a capitalization of the "guess" earnings of the new concern and comparing the valuation so arrived at with the total claims of the old senior securities. The present plan fails to meet this test, as junior interests are allowed to participate in the new capital structure of Railways when it is conceded that Railways' common is not worth $98,700,000 on any basis of valuation. If the claims of the preferred stockholders are to be treated as matured as in an equity or bankruptcy reorganization, there can be no participation for the common stock under the "absolute priorities" rule.

It was stated in Consolidated Rock Products Co. v. duBois, 312 U. S. 510, that the method of valuation formulated with respect to railroad reorganizations—which regards an estimate of future earnings the most important criterion—applies equally to industrials. Does this mean that after valuation has been determined, the rights of security holders of a utility must be determined by these same rules in a substantially dissimilar situation?

The Commission concluded that the changed circumstances which a company finds itself in where bankruptcy is present may not be and often is not the changed circumstances a company finds itself in as it attempts to comply with the Public Utility Holding Company Act of 1935. It therefore was of the opinion that "fair and equitable" should be given a different construction under the Public Utility Holding Company Act than had been given in re-

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[4] Case v. Los Angeles Lumber Products Co., 308 U. S. 106; Consolidated Rock Products Co. v. duBois, 312 U. S. 510; Marine Harbor Properties v. Manufacturers T. Co., 317 U. S. 78; Ecker v. Western Pacific R. Co., — U. S. —; and Institutional Investors v. Chicago, M., St. P. & P. R. Co., — U. S. —.

[fol. 100] organizations in equity and under the Bankruptcy Act,[5] and, in holding bankruptcy techniques inapplicable, consequently refused to treat the claims of the preferred as having matured. The Commission gave participation to the common in the reorganized company, even though the valuation of the reorganized company, as determined by a capitalization of its prospective earnings, was not equal to the $98,700,000 claim of the preferred stock. Having determined that the value of the reorganized company is insufficient to meet the preferred stock claim, the Commission found it unnecessary to make an over all dollar valuation of the company, for it measured and determined participation according to the substantive rights of security holders as they would exist apart from the required reorganization. In the opinion of the Commission, to mature liquidating preferences would be to add to the value of one class of securities at the expense of the other.

This is a new approach to the problem. The quantity of participation, the Commission found, should be expressed in terms of a percentage of the new stock, without being reduced to dollar figures; and this finding is based, of course, on the proposition that the Commission also found it was not detrimental to the interests of investors.

In other words, after capitalizing reasonable prospective earnings, the Commission found that that sum was insufficient to meet the liquidating preferences of the preferred stock by a wide margin. Under the orthodox approach, that would end the problem, and there would be no participation for the common. The Commission, however, to determine participation, projected prospective earnings much further into the future than would be permissible if the rights of the preferred stock were to be treated as matured. In this case, even on the assumption of liberal earning power, and on the assumption that all earnings [fol. 101] were paid to preferred stockholders, it would take fifteen years to pay off the dividend arrearages. The Commission concedes that the possibility of the common acquiring value is remote; but, nevertheless, it was of the

[5] It is significant to note that there is some Congressional dissatisfaction with the "absolute priorities" rule even as applied to reorganizations under the Bankruptcy Act. See H. R. 2857, 78th Cong. 1st Session.

opinion that the common should be accorded this right in the light of the possibility that future earnings may prove to be greater.

There are weighty reasons why the junior security holders should have an opportunity to recoup their losses in the future, even though probability of realization is not apparent from an estimate of the prospective earnings within a reasonable time. Especially is this so where (as here) the financial affairs of the corporation are such that it would not be forced to liquidate apart from the necessity of complying with the provisions of the Act. The mere fact that estimated prospective earnings within a reasonable time are inadequate for the common stockholders to recoup their losses should not form a basis for wiping out their interests when under normal conditions they would be entitled to a continuing participation in the enterprise. In short, the common stockholders should be given a chance to recoup, especially where the reason for liquidation is purely fortuitous, and where the future condition of the new enterprise is based on a surmise.

The statement of the principle behind the decision of the Commission was this: "* * * if a class of preferred stock has a reasonable interest in an enterprise absent the maturing of liquidation preferences and a proportionately greater interest upon the maturity thereof, it would not be fair or equitable under the statute to give recognition to the greater interest at the expense and to the detriment of the common stock. And conversely, if the common stock has a measurable interest apart from the maturing of liquidation preferences, we must not sanction the destruction of that interest through the operation of the statutory mandate." The majority's apologia for its break with Commissioner Healy is just as adequate. They explained: "It [fol. 102] is pointed out in Commissioner Healy's separate opinion that the words 'fair and equitable' embodied in Section 11 have a settled meaning, as determined by the courts, and that an application of the 'absolute priorities' doctrine must result in no distribution to Power's common stock in this case. But that is because he measures the rights of the preferred stock as they would be measured in bankruptcy cases, and not merely because he follows the 'absolute priorities' doctrine in determining the consequences of the measurement. In other words, we can agree with him

when he says that absolute priorities must be respected, because we think that doctrine simply means that the common stock must not be accorded any participation unless the preferred stock has been fully compensated for its rights and priorities. But there the area of agreement stops, because he says further that the rights and priorities of the preferred stockholders are the same here as in bankruptcy cases, where their claims to liquidation preferences (including dividend arrearages) are treated as matured. In our view it would be unconscionable and contrary to the plain intention of Congress to so hold."

There is nothing sacrosanct about the rights of the preferred, and they are not now asked to give to the common what is exclusively theirs. The rights of all parties must be dependent upon the particular facts of each case which comes before the Commission.

A consideration of the basic facts before the Commission supports its special finding of what is fair and equitable under all the circumstances. True, the preferred has a charter claim of $164.50 per share in cash upon dissolution, as that term is ordinarily understood when total corporate assets are either sold privately or on the block and liquidation, in the sense that total corporate purpose ceases, takes place. But, the Commission has caught the nuance in the present situation. There is no real finality to this particular dissolution. Power's shareholders simply transform themselves into holders of common stock of Railways and [fol. 103] thus obey the demands of Congress. Power as the head of a holding company system is now declassé by congressional mandate; the interests of all classes of stock are nevertheless still lodged in a continuing enterprise.

While the preferred's dividend arrearage is a claim upon capital under, at least, one decision[6] I do not think this claim should black-out considerations of common's contribution to that same capital. Common's contribution to capital amounts to $28,482,745—preferred's $60,000,000. After deduction of dividends, net contribution is $19,729,949

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[6] Argument that dividend arrearages should not be a claim on capital in all cases made by the writer of this opinion was rejected by the Supreme Court of Delaware in Penington v. Commonwealth Holding Const. Corp., 17 Del. Ch. 394, 155 A. 514, in 1931.

for common and $49,461,882 for preferred. But undistributed earnings have been plowed in since 1929—$4,073,155 by common and $38,700,000 by preferred. And while preferred has a capital claim for its par and an arrearages "capital claim" [sic] on non-existing earnings totalling $98,700,000, the plan should not disregard common's capital claim of $19,729,949.

It is neither an exercise in semantics nor a rejection of labels to consider the present plan little more than a reclassification.[7] If it had donned the formal dress of reclassification by way of merger, the preferred may have been met with the issuance of a new stock with a reduced dividend rate and a wiping out of its dividend arrearage claim. In any such reorganization, the mere pittance of 5.48% of Railways' stock thrown to the common would manifestly be regarded as not only fair and equitable but downright generous to the preferred. But the Commission having determined that an allocation of 95% of the equity should go to the preferred, likewise determined that the shortest way to compliance with the Act was direct liquidation without pausing to go through the legal legerdemain [fol. 104] of recapitalization followed by formal liquidation which, in all probability, would have delayed the time the preferred's investment could be put on a dividend paying basis.

The Act was a command of the government. Contractual relationships must, *ex necessitatae*, give slightly in the face of such legislation. It is my view that Congress never contemplated or intended that preferred shareholders of public utility holding companies were to be, if shrinkage of assets occurred, the sole owners of the corporate enterprise. Moreover, the case history of railroads—which gave rise to the "absolute priority" rule—pressed by increased truck and air transportation competition, is no economic analogue to the electric power industry. The railroad industry is decadent, whereas the electric power industry has all the characteristics of growth. This is an additional

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[7] In Puget Sound Power & Light Company, Holding Company Act Release No. 4255, approved and enforced by an order of the District Court in Massachusetts on June 10, 1943, there was a recapitalization on a one-stock basis; in short, a recapitalization effected without maturing the liquidation preferences of the preferred.

reason supporting the approach of the Commission in the allocation of participation in the new venture, for the future potentialities of the electric power industry are incalculable.

The approach to values by Commissioner Healy—while based on the facts of Power's earnings—overlooks two propositions: (1) the 1929-38 national depression period for public utilities; and (2) as normal revenues came back into the picture, a heavy taxation schedule made its appearance in the face of an international war. In the light of corporate history, as we have come to know it, such factors of income and expense are abnormalities.

The question remains whether the approach of the Commission can be supported under the language of the Act. This particular problem is one of statutory construction. It is urged that the expression "fair and equitable" as used in the Act is a term of art and has a settled meaning, i.e., that the rule of "absolute priorities" must be followed for the plan to be fair and equitable, and that under the well known rule of statutory construction, Congress must be presumed to have used the language it did use to convey the settled meaning. I refuse to accept the [fol. 105] application of this rule of construction to these proceedings. The Act marks a radical departure from all previous legislation. Moreover, the dominant purpose of the Bankruptcy Act is the elimination of claims without value (See In re 620 Church St. Corp. 299 U. S. 24) *whereas the dominant purpose of the Public Utility Holding Company Act is the enhancement of security values through integration* for the protection of investors. Bankruptcy techniques are wholly inapplicable because Power is not insolvent or in any financial difficulty in the traditional bankruptcy or equity sense. I consequently hold that the expression "fair and equitable" as used in the Act does not have the restricted or formal meaning accorded it by the cases supporting the "absolute priorities" rule.

The test of fairness under the Act does not involve the application of a precise mathematical formula. Fair and equitable are not arithmetical, algebraic, or geometrical. There can be no hard and fast rule when dealing with these terms. The requirements of "fair and equitable," as the Commission correctly concluded, depend upon the particular setting. The words "fair and equitable" may have a definite meaning given them in reorganization in

equity and under the Bankruptcy Act, but they may also have another meaning where a company is attempting to comply with the provisions of the Public Utility Holding Company Act of 1935, *unless the financial condition of such company is such that it faces liquidation apart from the necessity to comply with the statute.*

The majority opinion expresses "a more sensitive regard for what is right and what is wrong" in a distribution of assets under the Act. Hence, the Commission's evaluation of what is fair and equitable prompted it to reject the proposition that the common shareholders should be eliminated from any future interests in that enterprise. In considering whether the plan was fair and equitable to the preferred, the Commission took into consideration that the preferred had no voice in the management. There [fol. 106] was obviously a small distribution of voting power. Class B common, representing about $4,000,000 of book capitalization, exercised the voting control of the whole system having a consolidated capitalization and surplus of nearly $500,000,000.

After careful consideration of the interests of all its shareholders, Power's management in 1940 originally submitted a plan calling for an 8.8% allocation to their common shareholders. The Commission thought the allocation too high. This fact is not without significance. Preferred stockholders cognizant of the plan for over two years made no opposition. Widespread acceptance by a class of shareholders of a tactic which looks to dilute their financial interest in their corporate enterprise is a reality which no court should disregard. It seems to me a powerful argument for court approval of a plan of distribution of the property of a public utility holding company when not only the Commission recommends, but also where the plan is considered by practically all the owners of such property to be fair and equitable. The interest behind the 10 preferred shares of the dissidents, when compared with the 5% allocation to all the common shareholders, might very well fall into the realm of *di minimus.* Such a view brings a rule of life into a rule of law.

In my opinion, the expression "fair and equitable" should be given its ordinary non-technical meaning. As stated before, the dominant purpose of the Act is the protection and enhancement of public utility security values through integration. But the application of the "absolute priori-

ties" test would in many cases wipe out the interests of stockholders who, save for the passage of the Act, would be entitled to a continuing participation in the enterprise. The expression "fair and equitable", in its ordinary connotation, does not impel such a result; and I will not ascribe such an unnatural intention to Congress. Moreover, it must be apparent that, as I have indicated above, there are many ways to effectuate the purposes of the Act; and, in many [fol. 107] cases, the junior securities' holders would be entitled to a participation if other methods of reclassification are utilized. The choice of procedural alternatives should not affect the substantive rights of the common shareholders.

I believe there exists judicial authority which supports the new approach of the Commission. In Securities and Exchange Commission v. Chenery Corp., 87 L. Ed. Advance Opinions, p. 411, the Supreme Court, in considering the fair and equitable standard proposed by the Act, said: "Determination of what is 'fair and equitable' calls for the application of ethical standards to particular sets of facts, but these standards are not static. In evolving standards of fairness and equity, the Commission is not bound by settled, judicial precedents. Congress certainly did not mean to preclude the formulation by the Commission of standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time the Public Utility Holding Company Act of 1935 became law."

The remaining question is whether the particular plan comes within the standards of fair and equitable as set forth in the Chenery Corp. case. I think the plan abundantly meets these standards. The Commission must have considerable discretion and its informed judgment is entitled to considerable weight. There is no suggestion anywhere that, assuming the Commission has the power to give common anything, 5% is too large. And moreover, if the Commission's estimate as to earnings (which estimate furnished the basis of the common's participation) is too high, the preferred stockholders who receive 95% of the common stock are only damaged to the extent of 5% while, if the Commission's estimate is too low, the common stockholders would be damaged to the extent of 95% or more. In view of the uncertainties of the future, and in view of the fortuitous liquidation of the old company I

think the participation accorded the common is fair and equitable to all classes of stockholders.

[fol. 108] Accordingly, I approve the plan as fair, equitable and appropriate to effectuate the provisions of Sec. 11. A proposed form of decree may be submitted.

(S.) Paul Leahy, J.

Dated: Jul. 30, 1943.

[fol. 109] In United States District Court

Decree—August 4, 1943

A certain plan to effectuate the provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 (hereinafter called the Act) having been filed with the Securities and Exchange Commission by The United Light and Power Company, said plan being dated June 29, 1942; and the Commission, after notice and opportunity for hearing, having entered its findings and opinion dated April 1, 1943, approving said plan, subject to the condition that said plan be modified in respect to the participation to be accorded the preferred and common stockholders of The United Light and Power Company; said company having on April 2, 1943, filed an amendment modifying said plan in accordance with the conditions stated in said findings and opinion of the Commission; the Commission, on April 5, 1943, having entered its supplemental findings and opinion and its order approving said plan as so amended, which plan as so modified is hereafter referred to as the "Plan"; and the Commission, after notice and opportunity for hearing, having found the Plan necessary to effectuate the provisions of subsection (b) of Section 11 of the Act, and fair and equitable to the persons affected thereby; and The United Light and Power Company having requested the Commission to apply to a court to enforce and carry out the terms and provisions of the Plan; and the Commission, on April 16, 1943, having filed with this Court an application to enforce and carry out the terms and provisions of the Plan; and this Court by order dated April 16, 1943, having fixed June 15, 1943, as the date for hearing upon the Plan; and it appearing from the affidavit of H. B. Munsell that due and sufficient notice of said hearing was duly given in accordance with the provisions of said order of April 16,

1943; and objections having been filed by certain stockholders of The United Light and Power Company to the Plan; and the Commission, The United Light and Power Company and Otis & Co., a holder of 10 shares of the pre-[fol. 110] ferred stock of The United Light and Power Company, having appeared by their counsel, and this Court having duly considered the Plan, the objections and the evidence, and the Court being fully advised in the premises;

It Is Hereby Found, Ordered, Adjudged and Decreed:

1. Subject to the terms and conditions of the Commission's order of April 5, 1943, as set forth in Exhibit C to its application herein, the Plan is approved as fair and equitable, and as appropriate to effectuate the provisions of Section 11 of the Public Utility Holding Company Act of 1935.

2. Subject to the terms and conditions of said order of the Commission, this Court, for the purpose of carrying out the terms and provisions of the Plan, hereby takes exclusive jurisdiction of The United Light and Power Company and the assets thereof, wherever located.

3. Pending the transfer of its assets in accordance with the Plan, and except as otherwise provided by any order in this proceeding, The United Light and Power Company shall retain possession of its assets and continue the operation of its business through its officers, directors and employees in accordance with its articles of incorporation and its by-laws.

4. The United Light and Power Company, and its officers and directors, are hereby authorized, ordered and directed to take and to cause to be taken, as soon as practical after this order is no longer subject to appeal or review in any higher court, all action necessary on their respective parts to carry into effect the steps and transactions specified in paragraphs 1 to 13, inclusive, of The Plan, which is set forth in "Amendment Number 1 to Application Number 14" before the Securities and Exchange Commission, a copy of which amendment is attached hereto, and made a part hereof.

5. On or before the distribution date referred to in the Plan, The United Light and Power Company shall file with [fol. 111] the Court satisfactory proof that its assets, ex-

clusive of the common stock of The United Light and Railways Company, are adequate to satisfy all its liabilities and expenses in the manner provided in paragraph 11 of the Plan.

6. In accordance with the consent of The United Light and Railways Company, filed herein, the checks distributed in accordance with paragraph 9 of the Plan shall not become void prior to August 1, 1948, and the notation on the face of said checks shall so state.

7. On and after the distribution date referred to in the Plan, the sole right and interest of the holders of the $6 Cumulative Preferred stock, the Class A Common stock, and the Class B Common stock of The United Light and Power Company in the corporation shall be to receive (subject to paragraph 9 of the Plan) the common stock or scrip of The United Light and Railways Company, in accordance with the provisions of the Plan.

8. Jurisdiction of the assets of The United Light and Power Company may be released upon the transfer of such assets as provided in the Plan.

9. All creditors and stockholders of The United Light and Power Company, and all other persons, are hereby enjoined and restrained from doing any act or taking any action interfering with, or tending to interfere with, these proceedings, or with the carrying out of the Plan or any part thereof, including the commencement or prosecution of any action, suit or proceeding at law or in equity, or under any statute in any court or before any executive or administrative officer, commission or tribunal.

10. The Court reserves jurisdiction to enter such supplemental orders and to give such further relief as may be necessary and appropriate to enforce and carry out the provisions of the Plan.

By the Court. Paul Leahy, *United States District Judge.*

Dated August 4th.

[fol. 112] Before the Securities and Exchange Commission

Amendment No. 1 to Application No. 14

In the Matter of The United Light and Power Company, et al., Respondents and Applicants

(File Nos. 59-11, 59-17 and 54-25)

Sections 11 (b) (1), 11 (b) (2) and 11 (e) of the Public Utility Holding Company Act of 1935

To the Securities and Exchange Commission:

The undersigned, The United Light and Power Company (hereinafter called "Power"), and The United Light and Railways Company (hereinafter called "Railways"), hereby amend Application Number 14 in the above entitled proceedings by modifying the Plan set forth on pages 3, 4 and 5 of said Application so that said Plan as modified shall read as follows:

The Plan

(As Modified)

1. The authorized Common Stock of Railways, now consisting of 1,000,000 shares of the par value of $35 each, shall be changed into 3,500,000 shares of Common Stock of the par value of $7 each; the 708,520 shares of Common Stock of said company of the par value of $35 each now outstand-[fol. 113] ing shall be exchanged for 3,173,838 shares of the new Common Stock of the par value of $7 each; and the capital of said company shall be reduced by $2,581,334 by reducing the amount of capital represented by the outstanding Common Stock from $24,798,200 to $22,216,866, the amount of the reduction to be credited to paid-in surplus. These changes shall be effected by appropriate action under the corporation law of Delaware upon the vote or written consent of Power as the holder of all the outstanding Common Stock of Railways.

2. On and after the distribution date (defined in Paragraph 12 hereof) the Common Stock of Railways to be owned by Power after the changes outlined in Paragraph 1 hereof have become effective shall be distributed among

the stockholders of Power in complete liquidation of their rights as such stockholders on the following basis:

> Five shares of the Common Stock of Railways shall be distributed to the holder of each share of the $6 Cumulative Preferred Stock of Power, and, subject to the provisions of paragraph 3 hereof, one-twentieth of a share of the Common Stock of Railways shall be distributed to the holder of each share of the Class A Common Stock and the Class B Common Stock of Power.

3. Each Common stockholder of Power who would be entitled to a fraction of a share of the Common Stock of Railways on the basis set forth in Paragraph 2 hereof shall, in lieu thereof, receive non-interest bearing, non-dividend bearing, and non-voting scrip in bearer form, to be issued by Railways. Such scrip, when combined to aggregate one or more full shares, may be surrendered to Railways on or before, but not after July 1, 1944, in exchange for full shares of Common Stock of Railways. All scrip which has not been surrendered as above provided shall become void, and from [fol. 114] and after July 1, 1944, the holders thereof shall be entitled to no rights whatsoever with respect thereto.

4. The distribution of Common Stock and scrip of Railways pursuant to Paragraphs 2 and 3 hereof shall be made by the Depositary referred to in Paragraph 5 hereof upon surrender to the Depositary by the stockholders of Power of the certificates representing the shares of stock of Power held by them or upon the furnishing by such stockholders of proof satisfactory to the Depositary as to the loss or destruction of such certificates accompanied by indemnity satisfactory to Power, Railways and the Depositary indemnifying Power and Railways (and their transfer agents and registrars) and the Depositary against any liability or expense incurred by making such distribution without requiring the surrender of such certificates. All certificates representing stock of Power so surrendered shall be properly assigned to Power or endorsed in blank. All certificates surrendered to the Depositary shall be delivered to or upon the order of Power for cancellation by it.

5. On or before the distribution date, Power shall deposit with a bank or trust company to be selected by it

(herein called the "Depositary") certificates representing the shares of Common Stock of Railways to be distributed to the stockholders of Power. Power shall irrevocably authorize the Depositary to transfer said shares or to cause the same to be transferred to or upon the order of the stockholders of Power entitled thereto in accordance with the provisions of the Plan. Whenever scrip certificates are required for distribution in accordance with Paragraph 3 hereof, the Depositary shall surrender to Railways certificates representing full shares of its Common Stock and Railways shall deliver to the Depositary in exchange therefor scrip certificates aggregating the number of full shares [fol. 115] so surrendered. Railways shall at all times, to and including July 1, 1944, reserve in its treasury for delivery in exchange for outstanding scrip such number of shares of Common Stock as shall equal the aggregate number of shares exchangeable for such scrip.

6. At least fifteen days prior to the distribution date, Power shall mail or cause to be mailed to each stockholder of record a notice advising such stockholders of the procedure to be followed by them in connection with the distribution of Common Stock of Railways pursuant to the provisions of the Plan. A similar notice shall be published in at least one daily newspaper of general circulation published in the Borough of Manhattan, City and State of New York, and at least one daily newspaper of general circulation published in the City of Chicago, Illinois, at least once in each calendar week (in each instance on any day of the week) for two successive weeks, the first publication to be at least fifteen days prior to the distribution date.

7. The stock transfer books of Power shall be closed on the distribution date, and on and after said date the stocks of Power shall cease to be transferable on its books.

8. If any dividend shall be paid upon, or any other distribution shall be made with respect to, the Common Stock of Railways while any shares thereof are held by the Depositary, the portion of such dividend or distribution applicable to the shares of Common Stock held by the Depositary shall be paid or delivered to the Depositary and held by it for distribution to the persons entitled to the shares of Common Stock of Railways to which such dividend or distribution relates, such distribution to be made

to such persons in accordance with the provisions of Paragraph 4 hereof. Any cash or other property so received by the Depositary as a dividend or other distribution with respect to any shares of Common Stock of Railways which [fol. 116] are thereafter surrendered to Railways in connection with the issuance of scrip pursuant to Paragraph 5 hereof, shall be returned by the Depositary to Railways. While shares of Common Stock of Railways or other securities are held by the Depositary all voting rights with respect thereto shall remain vested exclusively in Power.

9. The right of the stockholders of Power to receive Common Stock or scrip certificates of Railways as provided in Paragraphs 2, 3, and 4 hereof shall expire July 1, 1944. As soon as practicable after July 1, 1944, the Depositary shall sell all shares of the Common Stock of Railways and all other securities at the time held by the Depositary for cash either at public or private sale. The Depositary shall thereupon distribute to the remaining stockholders of record of Power their aliquot portion of the net proceeds of such sale plus their aliquot portion of any cash dividends or distributions held by the Depositary which are applicable to the shares of Common Stock of Railways sold by the Depositary. Such distribution shall be effected by mailing a check for the amount payable to each stockholder of record of Power to the address shown on the stock ledgers of Power. After July 1, 1944, the stockholders of Power shall have no rights whatsoever other than as provided in this paragraph. All checks which have not been presented for payment within one year after the date thereof shall become void and shall bear a notation to such effect on their face. All funds represented by checks becoming void as above provided shall be paid by the Depositary to Railways or its assigns.

10. From and after the distribution date, the holders of the $6 Cumulative Preferred Stock, the Class A Common Stock, and the Class B Common Stock of Power shall have only the rights specifically set forth herein, and all other rights (including voting rights) of such persons as stockholders of Power shall cease and become void on the distribution date.

[fol. 117] 11. Power, after paying or providing for the payment of all its liabilities and expenses and prior to the completion of its dissolution, shall contribute to the paid-in

surplus of Railways all remaining cash, securities and other property (except the Common Stock of Railways) owned by Power or with respect to which Power may have an interest. In this connection, provision may be made for the payment of the liabilities and expenses of Power by the assumption thereof by Railways, but the amount of liabilities and expenses so assumed shall not exceed the fair cash value, as determined by the Board of Directors of Railways, of the assets to be contributed to it by Power.

12. Power shall request the Commission, pursuant to Section 11 (e) of the Act, to apply to a Federal court to enforce and carry out the terms and provisions of the Plan. If the court shall approve the Plan as fair and equitable and shall enter a decree enforcing the Plan and requiring its consummation, the distribution of Common Stock and scrip of Railways to the stockholders of Power in accordance with the Plan shall be made on and after the thirtieth day following the date on which such court decree becomes final and is no longer subject to judicial review. The date upon which such distribution shall be commenced is herein referred to as the "distribution date."

13. As soon as practicable after the distribution date Power shall be dissolved.

Pursuant to Section 11 (e) of the Act, Power hereby requests the Commission, upon the entry of an order approving the foregoing Plan as modified, to apply to an appropriate Federal court, in accordance with the provisions of subsection (f) of Section 18 of the Act, to enforce and carry out the terms and provisions of such Plan as modified.

[fol. 118] Signatures

Pursuant to the Public Utility Holding Company Act of 1935, the undersigned have caused this Amendment to be duly executed on their behalf by their duly authorized officers as of the 2nd day of April, 1943.

The United Light and Power Company, by H. B. Munsell, Vice President. (Corporate Seal.)

Attest: Thos. K. Humphrey, Secretary.

The United Light and Railways Company, by H. B. Munsell, Vice President. (Corporate Seal.)

Attest: Thos. K. Humphrey, Secretary.

[fol. 119] STATE OF ILLINOIS,
County of Cook, ss:

The undersigned being duly sworn deposes and says that he has duly executed the attached amendment dated April 2, 1943, for and on behalf of The United Light and Power Company, one of the companies named therein; that he is a vice president of such company; and that all action by stockholders, directors and other bodies necessary to authorize deponent to execute and file such instrument has been taken. Deponent further says that he is familiar with such instrument and the contents thereof, and that to the best of his knowledge, information and belief, the facts therein set forth are true.

H. B. Munsell.

Subscribed and sworn to before me, a notary public, this 2nd day of April, 1943. K. E. McGraw, Notary Public. My commission expires July 7, 1945. (Notarial Seal.)

[fol. 120] STATE OF ILLINOIS,
County of Cook, ss:

The undersigned being duly sworn deposes and says that he has duly executed the attached amendment dated April 2, 1943, for and on behalf of The United Light and Railways Company, one of the companies named therein; that he is a vice president of such company; and that all action by stockholders, directors and other bodies necessary to authorize deponent to execute and file such instrument has been taken. Deponent further says that he is familiar with such instrument and the contents thereof, and that to the best of his knowledge, information and belief, the facts therein set forth are true.

H. B. Munsell.

Subscribed and sworn to before me, a notary public, this 2nd day of April, 1943. K. E. McGraw, Notary Public. My commission expires July 7, 1945. (Notarial Seal.)

[fol. 121] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

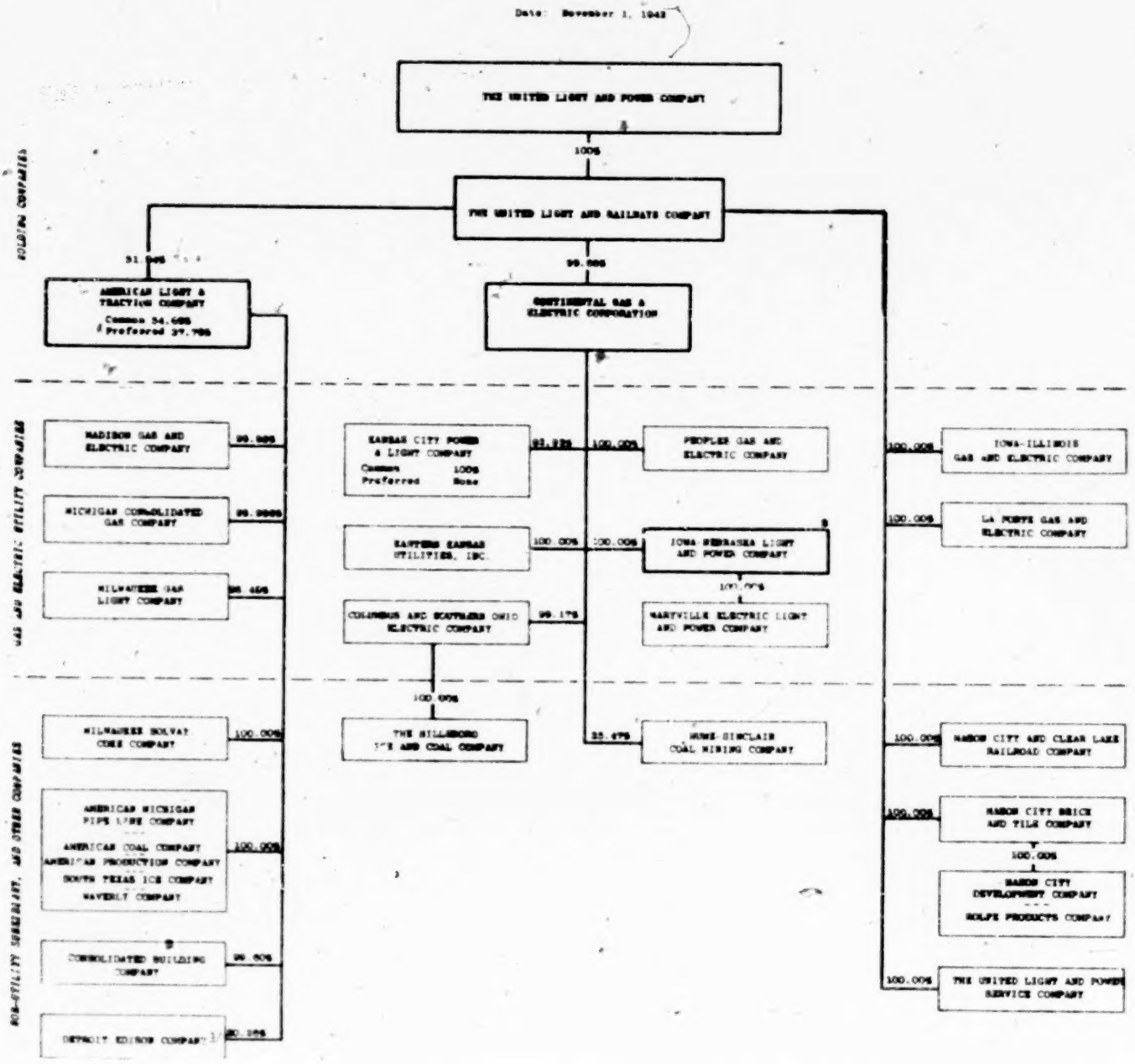
Appendix to Brief for the Securities and Exchange Commission

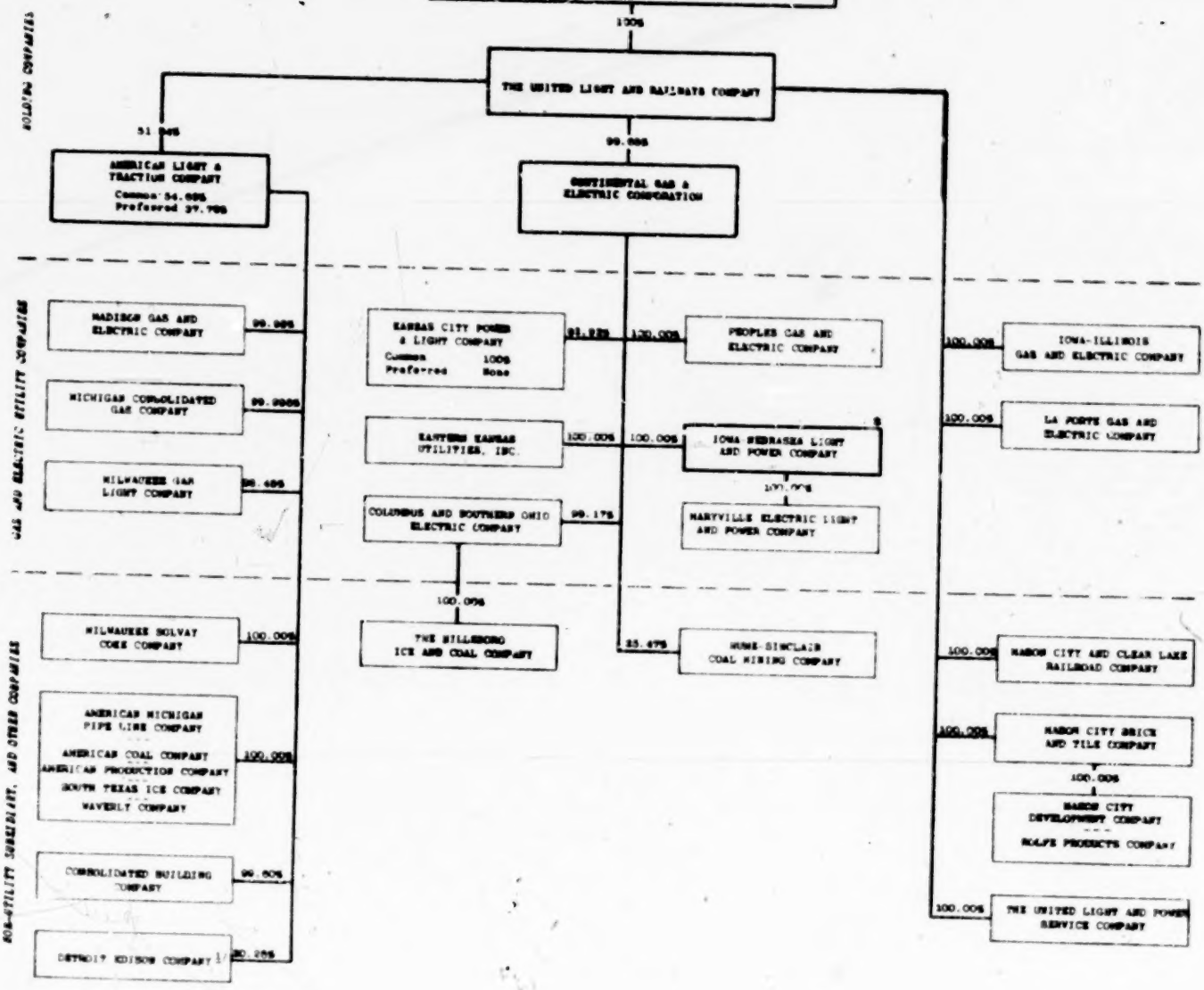
(Here follows 1 photolithograph, side folio 122)

EXHIBIT A

PRO-FORMA CORPORATE CHART OF POWER AND ALL SUBSIDIARIES THEREOF SHOWING THE PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OF EACH SUBSIDIARY HELD BY POWER AND EACH SUBSIDIARY COMPANY THEREOF (a)

Date: November 1, 1943





[*] Iowa-Nebraska Light and Power Company is also a holding company.

NOTE: The figure set forth immediately above the name of each subsidiary company indicates the percentage of the total voting power represented by the securities of the subsidiary owned by the designated holder of the securities of the subsidiary. In cases where less than all the voting securities are owned by the designated holder and the voting securities consist of more than one class of securities, the percentage of each class of voting securities owned by the designated holder is set forth within the rectangle designating the subsidiary.

[1] Exempt as subsidiary by order of commission of August 5, 1940.

[#] The corporate chart printed at page 35a of appellant's brief inadvertently follows the chart in the Findings and Opinion as originally released by the Commission, which contained certain typographical errors. A corrected copy of the Commission's Findings and Opinion was filed with the District Court in connection with the Commission's application for enforcement of the plan. The above corporate chart reflects such corrections.

[fol. 123] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

FINDINGS AND OPINION OF SECURITIES COMMISSION, DATED MARCH 20, 1941 *

(Caption, headnotes, appearances and appended corporate charts omitted.)

These proceedings were instituted on December 6, 1940, by order of the Commission pursuant to Section 11 (b) (2) [1] of the Public Utility Holding Company Act of 1935. Our order was based in large part upon the facts set forth in a [fol. 124] report prepared by our Public Utilities Division, with respect to The United Light and Power Company holding company system as to complying with the stand-

* Not the opinion under review.

[1] Section 11 (b) (2) of the Act makes it the duty of the Commission as soon as practicable after January 1, 1938:

> "To require by order, after notice and opportunity for hearing that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company."

ards of Section 11 (b) (2). The report was filed as part of the proceedings at the time the original order was issued, and was at that time served on the respondents and made available to the public. The substantial accuracy of the facts stated in the report has been conceded by the respondents and no issue of fact has been raised by any interested security holder. The Commission therefore finds that the statements of fact contained in the report of the Public Utilities Division, as subsequently corrected[2] and made a part of the record, are true and correct.

By the Commission's order of December 6, the proceedings then instituted under Section 11 (b) (2) were consolidated with an application previously filed by the Company for approval of a plan of recapitalization under Section 11 (e). That plan contemplated the issuance by The United Light and Power Company of one class of common stock in exchange for the presently outstanding stock of that company consisting of preferred stock, class A common stock, and class B common stock.

The hearing in the consolidated proceeding was convened on January 14, 1940. In order to clarify the issues in the proceeding, we considered it appropriate to sit at the opening of the hearing and we heard opening statements of counsel directed toward the appropriate method of procedure. At that time counsel for the respondents urged that the Commission consider first the recapitalization plan filed by the company; the respondents took the position that the carrying out of that plan would simplify the solution of the remaining problems of the holding company [fol. 125] system. Counsel for the Commission, on the other hand, pointed out that the holding company system as presently constituted failed to meet the mandatory requirements of the second sentence of Section 11 (b) (2),

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[2] The respondents suggested certain minor corrections in the report as originally filed; these corrections were made in a corrected copy which was subsequently introduced as part of the record. The respondents stated that the facts contained in this corrected copy of the report are true and correct, although they reserved the right to differ with certain of the conclusions and inferences in the report and reserved the right to offer additional facts where they deem them pertinent.

sometimes known as the "great-grandfather" clause, and urged that, unless some cause to the contrary was shown, an order should be entered promptly, as the first step under Section 11 (b) (2), requiring compliance at least with this mandatory provision of the statute. To achieve this purpose counsel for the Commission suggested that as a first step the Commission should order the dissolution of The United Light and Power Company unless a showing was made of other appropriate means of carrying out the statutory requirements. Counsel for the Commission pointed out that in the event that The United Light and Power Company were required to be dissolved, it would be unnecessary to solve many of the problems otherwise required to be solved under the recapitalization plan.

At the conclusion of the initial hearing the Commission adjourned the proceeding until the following week, for the purpose of enabling the Commission to consider the problems of procedure and to afford the respondents opportunity to consult with the Commission's staff on the various problems at issue.

Prior to the next hearing, representatives of the respondents conferred with the Commission's staff with respect to what action should be taken to bring about compliance with the "great-grandfather" clause and with respect to other procedural matters involved in the case. As a result of these conferences, counsel for the respondents presented at the next hearing, held before members of the Commission on January 24, 1941, three alternative methods for bringing about compliance with the "great-grandfather" clause. As a result of the conferences referred to, counsel for the respondents also acquiesced in the procedure suggested by counsel for the Commission of consider- [fol. 126] ing first the issues under the "great-grandfather" clause, rather than proceeding first with the recapitalization plan.[3] At the suggestion of counsel for the re-

[3] In fact, Mr. Richberg, counsel for the company said:

"• • • in the light of progress already made, as heretofore shown, we earnestly urge the approval by the Commission of a procedure along the lines on which we have been working in close coöperation with the Commission's staff, so that waste of time and effort in unnecessary hearings and records may be avoided so far as possible." (Record, p. 94)

spondents, the Commission adjourned the hearing for a month in order that the company might explore further the various considerations involved in each of the suggested methods of compliance to enable it to select one from among the three.

Following this hearing various conferences were held and considerable progress was made. When the hearing was reconvened before us on February 24, counsel for the Commission, after referring to the steps taken at the previous hearing, urged that the Commission again consider whether an order should not be promptly entered directing the taking of specific steps to comply with the "great-grandfather" clause. Counsel for the respondents elaborated in somewhat more definitive form the proposals which they had previously suggested and urged that, in lieu of having a definite order entered at that time, they be permitted to proceed voluntarily to complete the execution of these proposals prior to the entry of any definite order by the Commission under Section 11 (b) (2). The question thus presented was taken under advisement by the Commission.

After consideration we decided that the Commission should at the outset consider whether an order should not be entered promptly requiring compliance with the "great-grandfather" clause. Accordingly on March 1, 1941, we directed that the hearing be reconvened before an examiner on March 12, and that at the reconvened hearing the issues [fol. 127] be limited to a consideration of and to the taking of evidence with respect to what action should be required to be taken by the respondents in order to bring the holding company system into compliance with the requirements of the "great-grandfather" clause. The order also provided that for that purpose the Commission would consider whether one or more of the holding companies in The United Light and Power system should be liquidated, dissolved or merged, or should be required to take other action so that they should cease to be holding companies, and that the Commission would also consider what companies should take such action. It was made plain in the order that the

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Mr. Richberg, also stated:

"• • • we are not in any way contesting the fact that we should comply with the 'great-grandfather' clause." (Record, p. 95)

limiting of the matters to be considered at the reconvened hearing was without prejudice to the subsequent consideration of other issues under Section 11 (b) (2) in this proceeding.[4]

Pursuant to the order of March 1, the hearing was duly reconvened before a trial examiner and evidence was offered by the respondents as to the steps to be taken to comply with the "great-grandfather" clause. The record is now before us for disposition of these issues.[5]

The Holding Company System

The facts concerning the holding company system of The United Light and Power Company, as far as they are pertinent for present purposes, are fully set forth in the Re- [fol. 128] port of the Public Utilities Division. We do not deem it necessary to repeat all of these facts in detail. However, it may be stated that the holding company system has 23 operating subsidiaries which render electric and gas service in 14 states. In addition, certain of these electric and gas subsidiaries, and certain other companies in the system, conduct transportation, water, heat, ice, coke, and other businesses.

Financial statements introduced by the respondents show that the consolidated assets of the companies of The United Light and Power Company system aggregate as per books nearly $600,000,000. On a corporate basis the assets of

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[4] Counsel for the respondent stated that it was their hope that, on the basis of the evidence introduced at the hearing an order would be entered which would mark definite progress toward compliance with Section 11 (b) (2) and which might thereafter be supplemented by future orders authorizing or requiring other detailed steps in the course of compliance with the first order.

[5] Counsel for Allied Chemical & Dye Corporation, a substantial security holder of American Light & Traction Company, one of the holding companies in the system, appeared and participated in the hearing. There was present also counsel for Koppers Company, a large holder of Class B common stock of The United Light and Power Company. Opportunity was given to other security holders to be heard and no other evidence or arguments were presented.

The United Light and Power Company are approximately $120,000,000.

The capitalization of The United Light and Power Company, as of December 31, 1940, may be summarized as follows:

The United Light and Power Company

Long Term Debt:		
First Lien 6's due 1952 (a)	$10,578,000	
First Lien 5½'s due 1959	6,678,600	
Total Secured Debt		$17,256,600
Debentures 6's due 1975	10,965,900	
6½% Debentures due 1974	5,534,000	
6½% Debentures due 1973	2,578,000	
Total Debentures		19,077,900
Total Long Term Debt		$36,334,500
Preferred Stock:		
$6 Cumulative at par value (b)		60,000,000
Common Stock—at stated values:		
Class A	9,684,768	
Class B	4,222,304	
Total Common Stock		13,907,072
Total Securities		$110,241,572

[fol. 129] (a) Not callable until April 1, 1947.

(b) Cumulative dividends in arrears—$31,500,000. All surplus has been transferred to a Reserve for Depreciation of Investments.

A corporate structure chart of the holding company system is set forth as Appendix A to these findings. It will be seen from this chart that the holding company system contains five tiers of companies. The system includes eight companies which are holding companies as defined in the Act; arranged according to corporate ownership with rela-

tionships indicated by indentations, these companies are as follows:

The United Light and Power Company
  The United Light and Railways Company
    United American Company
      American Light & Traction Company (A)
    Continental Gas & Electric Corporation
      Columbus and Southern Ohio Electric Company (B)
      Iowa-Nebraska Light and Power Company
    Northern Natural Gas Company

(A) American Light & Traction Company, by virtue of split ownership of its common stock, is a direct subsidiary of both United American Company and The United Light and Railways Company.

(B) Columbus and Southern Ohio Electric Company, while a holding company under the definition of Section 2 (a) (7), by virtue of its ownership of securities of Point Pleasant Water and Light Company, has been exempted from registration pursuant to Section 3 (a) and therefore is not a registered holding Company.

On the basis of the undisputed facts, it is clear that the holding company system does not comply with the require-[fol. 130] ments of the so-called "great-grandfather" clause. The second sentence of Section 11 (b) (2) provides as follows:

> "In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company."

This statutory provision, which is frequently referred to and which we have already referred to as the "great-grandfather" clause, requires that a holding company system be limited to a maximum of three tiers of companies. It is ap-

parent therefore that in order to meet those requirements several companies must be eliminated from the system or other steps must be taken so that such companies will cease to be holding companies.

Dissolution of The United Light and Power Company as a Step in Statutory Compliance

The record here, in our view, provides an ample basis for a finding in this case that The United Light and Power Company should be dissolved as a step toward securing compliance with the requirements of the "great-grandfather" clause. It is apparent from the record that, as the top of the pyramid of the holding company is approached, the effect of increasing corporate complexities accelerates the pressures on security holders of the system. The evidence introduced by the respondents also supports this conclusion.

The respondents' principal witness at the hearing on March 12, was H. B. Munsell, Vice President and Assistant to the President of The United Light and Power Company.[38] [fol. 131] In his testimony, he discussed various financial aspects of the holding company system and considered, in some detail, the elimination of one or more of the holding companies in the system in order to comply with the requirements of the "great-grandfather" clause. He discussed as possibilities, first, the elimination of The United Light and Power Company; second, the elimination of The United Light and Railways Company; and third, the elimination of American Light & Traction Company and Continental Gas & Electric Corporation.

Mr. Munsell expressed the conclusion that of the holding companies in the system The United Light and Power Company lends itself best to dissolution as a means of com-

[38] Mr. Munsell testified that he was a member and secretary of the company's Budget and Control committee, composed of five of the principal executive officers of the holding company, and that the committee decided and determined all matters of policy in so far as they were determined by executive officers. Mr Munsell testified that he was in general charge of all the company's problems under the Public Utility Holding Company Act, and that in his testimony he reflected the views of the company's executive officers.

plying with the "great-grandfather" clause. He described steps which might be taken by the respondents to effect its dissolution. In brief, these steps involve the acquisition by a new operating company, to be known as Peoples Light and Power Company, of the physical property of various direct operating subsidiaries of The United Light and Power Company, frequently known as the "First Lien Companies,"[6] and of United Power Manufacturing Com- [fol. 132] pany,[7] a subsidiary of The United Light and Railways Company. This new company would be owned by The United Light and Railways Company; it would assume the First Lien Consolidated Mortgage Bonds of The United Light and Power Company and would become substituted as the mortgagor in place of The United Light and Power Company. In order to finance this transaction, The United

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[6] The so-called First Lien Companies are so designated because their securities, and in some cases their physical assets, are pledged as security for the First Lien Consolidated Mortgage Bonds issued or assumed by The United Light and Power Company. The companies are Fort Dodge Gas and Electric Co., Moline-Rock Island Manufacturing Company, Peoples Power Company, Peoples Light Company, Cedar Rapids Gas Company, La Porte Gas and Electric Co., Iowa City Light and Power Co., Ottumwa Gas Company, Tri-City Railway Co. (Illinois), Clinton, Davenport & Muscatine Railway Company, Tri-City Railway Co. (Iowa), and Mason City and Clear Lake Railroad Co. With the exception of La Porte Gas and Electric Co., which the respondents propose to sell, all of the operations of the First Lien Companies are conducted in Iowa and the immediately adjoining area in Illinois. In addition to La Porte Gas and Electric Co., the respondents also propose to dispose of Clinton, Davenport & Muscatine Railway Company and Mason City and Clear Lake Railroad Company. Upon the completion of the consolidation, the new company will have a gross plant account of approximately $41,600,000 with a depreciation reserve of $9,974,000.

[7] United Power Manufacturing Company owns a generating station which is leased to certain of the First Lien Companies, and an office building in Davenport, Iowa, which is used by the Tri-City companies.

Light and Railways Company proposes to sell its investment in Northern Natural Gas Company and certain miscellaneous investments. Funds so received would be used by The United Light and Railways Company to acquire from The United Light and Power Company (through the medium of the new operating company) the properties now controlled by the First Lien Companies. With the funds so received The United Light and Power Company would be able to retire at par [8] all its publicly held debt other than the First Lien and Consolidated Mortgage Bonds.[9]

[fol. 133] The respondents have proposed that The United Light and Power Company sell its interest in Northern Natural Gas Company. Such sale is proposed to be effected by a distribution through underwriters of the common stock of the Northern Natural Gas Company now held in the Portfolio of The United Light and Railways Company. The terms of the proposed sale are not before us and we do not pass upon them; we consider it plain, however, that the disposition of this company is, from the standpoint of The United Light and Power Company holding company system, appropriate if not required under the applicable statutory standards.

The evidence shows that the dissolution of The United Light and Power Company will, together with the taking of certain minor steps, solve the problems presented by the "great-grandfather" clause. The testimony regarding the

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[8] It is proposed that the debentures of The United Light and Power Company be paid at par. These debentures provide for premiums of 8 or 9 points (for different series) which are required to be paid upon voluntary redemption. Respondents stated that the proposed program could be carried out even though payment of the redemption premium would be legally necessary. Like other details of the proposed program it is unnecessary for us to consider, at least this time, whether such redemption premium must be paid on dissolution.

[9] The respondents propose that the First Lien Bonds be assumed by the successor operating company; they state that under the applicable indenture provisions The United Light and Power Company, upon such assumption, will be released from further liabilities with respect to these bonds.

propriety of dissolving The United Light and Power Company indicated that to bring about that result certain other incidental steps should also be taken.

If these various steps were taken, as outlined by respondents' evidence, The United Light and Power Company would not longer have any debt and its assets would consist almost exclusively of the common stock of The United Light and Railways Company. Upon the consummation of these transactions The United Light and Power Company proposes to distribute this stock to its own stockholders (preferred, Class A common, and Class B common).[9a]

Mr. Munsell indicated that in his opinion the rights of security holders would not be adversely affected. So far as the holders of bonds secured by the First Lien Indenture are concerned, they would continue to have a first mortgage on the physical properties of the "First Lien Companies".[10] [fol. 134] The other debt securities of The United Light and Power Company are proposed to be paid at par. In this connection, he stated that the debentures which are proposed to be paid off at this time are selling at market prices substantially below their par value.[10a]

So far as the stock is concerned, the evidence indicates that the present stockholders of The United Light and Power Company should be benefited by the receipt of common stock of an underlying holding company, since they will

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[9a] It was recognized that a proposed plan of distribution would have to be approved by this Commission as fair and equitable to those affected thereby.

[10] Except to the extent that certain of these properties might not be included in the new operating company, but some reduction in the total amount of bonds outstanding will result from partial redemption with proceeds from the proposed sale of the La Porte, Mason City and Clear Lake railroad properties.

[10a] While the record does not contain figures showing market prices of these securities in the past, recognized financial publications and the Commission's records in other proceedings show that these debentures have, ever since the year 1931, sold at prices substantially below their par value. Certain of these figures are set forth in our opinion in *In the Matter of The United Light and Power Company* (1940), Holding Company Act Release No. 2348, p. 4.

be that much nearer to the assets and income of the operating companies.

With respect to the effect of the proposed program on the security holders of The United Light and Railways Company, the evidence showed the capitalization of that company, which was as follows as of December 31, 1940:

The United Light and Railways Company

Long term debt—5½% debentures		$24,316,000
Preferred stock (par)		
7% Series	$3,886,900	
6.36% Series	5,312,300	
6% Series	10,083,400	
Total Preferred Stock		19,282,600
Common stock (stated value)	24,798,200	
Paid-in surplus	45,789,200	
Earned surplus	1,827,302	
Total common stock and surplus		72,414,702
Total capitalization		$116,013,302

[fol. 135] As a result of the aforedescribed proposal to eliminate The United Light and Power Company, the outstanding securities of The United Light and Railways Company would be slightly reduced by virtue of the proposed donation by The United Light and Power Company of its holdings of approximately $600,000 of securities of the Railways company to the latter. Paid-in surplus would be increased as the result of this donation together with the additional donation by the Power Company of its holdings of Continental debentures ($607,500), service company stock ($248,600), and the miscellaneous investments. It appears from the record that asset values and earnings of The United Light and Railways Company would both be increased. This increase would result from the proposed acquisition by The United Light and Railways Com, any of the First Lien Properties now owned by The United Light and Power Company. It appears from the testimony that, as a result of carrying out the plan, the new operating company (owning the properties now belonging to the First

Lien Companies) would be in a position to consider refunding its outstanding bonds at substantially lower rates of interest.[11]

The elimination from the holding company system of United American Company presents no substantial problems. United American Company has no publicly-held securities, and its elimination involves merely the transfer of its assets, consisting principally of stock of American Light & Traction Company, to its parent, The United Light and Railways Company.

With the foregoing steps accomplished, there would still remain four tiers of companies in the line of control which runs through The United Light and Railways Company and Continental Gas & Electric Corporation by reason of the fact that the latter has two holding company subsidiaries, namely Columbus and Southern Ohio Electric Company and Iowa-Nebraska Light and Power Company. The Columbus [fol. 136] Company is a holding company by reason of its control of Point Pleasant Water and Light Company, a relatively small company operating in the State of West Virginia, and Iowa-Nebraska Light and Power Company is a holding company by reason of its control of Maryville Electric Light and Power Company, likewise a relatively small company operating in the State of Missouri. Respondents have suggested that, for the purpose of complying with the great-grandfather clause, the two subsidiaries in question should be transferred directly to Continental, or that the Point Pleasant Company might be transferred outside of the system.

It is evident that the taking of these steps, which in themselves appear unobjectionable, would complete the action required to comply with the great-grandfather clause. However, we hesitate to direct the taking of such action at this time by reason of the fact that as a result of the further proceedings to be had herein it may turn out that other holding companies in the system represent unnecessary complexities and may need to be eliminated. Should that be the case the action suggested with respect to the Maryville and

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[11] Certain of these bonds to be assumed amounting to $10,578,000 are non-callable until 1947; if a refunding is then effected at lower rates of interest, there will result additional savings to the new operating company.

Point Pleasant companies might be unnecessary. It therefore seems to us appropriate at this time to reserve decision with respect to the Point Pleasant and Maryville companies until the other issues referred to are disposed of.

There is set forth as Appendix B of these findings a corporate chart prepared on a pro forma basis to reflect the taking of the various steps proposed by the respondents; there is also set forth as Appendix C a corporate chart showing the various eliminations and changes in the system's corporate structure.[12] It will be observed from these charts that, if the proposed transactions were consummated, The United Light and Railways Company would be the top [fol. 137] holding company of the system, and there would be compliance with the "great-grandfather" clause.

We wish to emphasize that we have considered the various possibilities for the elimination of different holding companies, and the proposed steps which were outlined by the company's witness for the elimination of The United Light and Power Company only as evidence bearing upon the question of which company should be eliminated. It is unnecessary for us to pass upon the various proposed steps to accomplish this result since it is enough for present purposes that action must be taken to comply with the "great-grandfather" clause. It appears, however, that the steps described by Mr. Munsell to effect the dissolution of The United Light and Power Company, are such that in broad outline they are consistent with the statute; this in itself is persuasive evidence that The United Light and Power Company is the company to be dissolved for the purpose of compliance with that clause.

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[12] These charts continue as separate corporations Tri-City Railway Company (Iowa) and Tri-City Railway Company (Illinois). The respondents have expressed a desire to include the properties of these companies in the proposed new operating company (Peoples Light and Power Company), but have indicated that, if the retention of the properties of the two railway companies is not permissible under the standards of the Holding Company Act, they will be willing to take steps so as to leave these companies as separate corporations which would be direct subsidiaries of The United Light and Railways Company.

Remaining Issues

The first sentence of Section 11 (b) (2) requires the Commission to direct each registered holding company and its subsidiaries to take such steps as may be necessary for eliminating undue and unnecessary complications in corporate structure and for distributing voting power fairly and equitably among security holders of a holding company system. The second sentence of the section, while it contains a specific mandatory provision with respect to eliminating all companies in excess of three tiers, is in our view not a limitation of the more general provision contained in the first sentence. It is a minimum criterion for simplification. Even though a holding company system may comply with the requirements of the second sentence, it must still take further action if the corporate structure is such as to [fol. 138] include any undue or unnecessary complexities or if there exists unfair or inequitable distribution of voting power.[13]

Conclusions

Under the circumstances of this case and on the record presented, we find that the liquidation and dissolution of The United Light and Power Company and United American Company are steps necessary to comply with the requirements of the statute. Accordingly, we conclude that an order should be entered at this time directing the liquidation and dissolution of these two companies. Our order will provide that the respondents shall proceed with due diligence to bring about the liquidation and dissolution of The United Light and Power Company and of United American Company, and that they shall make application to the Commission for the entry of such further orders as may be necessary or appropriate for that purpose; the order will reserve jurisdiction to enter such further orders in this proceeding as may be necessary or appropriate for that purpose.

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[13] In his testimony Mr. Munsell recognized that there were other problems existing under Section 11 (b) (2). The issues presented by Section 11 (b) (1) as applied to this system are pending in a separate proceeding. (*In the Matter of the United Light and Power Company*, File No. 59-11; see Holding Company Act Release No. 1961.)

Our order will also provide that the hearing shall be adjourned, subject to call upon such notice as the Commission shall deem appropriate, for the purpose of considering other issues presented under Section 11 (b) (2) and particularly to determine what other steps should be taken, by way of elimination of additional holding companies or otherwise, to bring about compliance with the requirements of Section 11 (b) (2) not disposed of by our present order.

By the Commission (Chairman Frank and Commissioners Healy, Eicher and Pike), Commissioner Henderson being absent and not participating.

Francis P. Brassor, *Secretary.*

[fol. 139] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

ORDER OF SECURITIES AND EXCHANGE COMMISSION, DATED MARCH 20, 1941

The Commission having previously instituted these proceedings pursuant to Section 11 (b) (2) of the Public Utility Holding Company Act of 1935; notice having been duly given to all interested persons, and all such persons having been given an opportunity to be heard, with respect to what action should be required to be taken by said respondents to comply with certain of the requirements of said Section 11 (b) (2), particularly the second sentence thereof; and

The Commission having filed its findings and opinion herein, in which the Commission finds, among other things, that the action hereinafter directed to be taken is necessary and appropriate for the purpose of bringing about compliance with the second sentence of Section 11 (b) (2);

It Is Hereby Ordered, pursuant to Section 11 (b) (2) of the Public Utility Holding Company Act of 1935, particularly the second sentence thereof, that;

1. The United Light and Power Company shall be liquidated and dissolved.

2. United American Company shall be liquidated and dissolved.

It Is Further Ordered that the respondents shall proceed with due diligence to comply with the foregoing order, and shall make application to the Commission for the entry of any further orders necessary or appropriate for this pur-

pose; and the respondent, The United Light and Power Company, may submit to the Commission herein for its approval a plan proposing a method of complying with Paragraph 1 of the foregoing order on a basis which is fair and equitable to its security holders, and providing for a determination of the relative rights and interests of its [fol. 140] security holders in connection therewith; and jurisdiction is hereby expressly reserved to enter such further orders in this proceeding as may be necessary or appropriate for the purpose of carrying out the steps hereinbefore required in this order.

It Is Further Ordered that jurisdiction be and is hereby reserved to enter such further orders as may be necessary or appropriate with respect to any of the remaining issues in these proceedings and particularly for the purpose of considering what action should be ordered to be taken by the respondents to bring about compliance with the further requirements of Section 11 (b) (2).

It Is Further Ordered that the hearing heretofore held herein be and is hereby adjourned subject to call hereafter upon such notice as the Commission shall deem appropriate.

By the Commission.

Francis P. Brassor, Secretary. (Seal.)

[fol. 141] In the United States Circuit Court of Appeals

Appendix to Brief for United Light and Power Co.

In District Court of the United States for the District of Delaware

Civil Action No. 303

In the Matter of the Application of the Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11(b) of the Public Utility Holding Company Act of 1935, with Respect to The United Light and Power Company

Notice to Stockholders

To the holders of $6 cumulative preferred stock, Class A common stock, Class B common stock of the United Light and Power Company, and to all other persons:

Notice Is Hereby Given, pursuant to an order of the District Court of the United States for the District of

Delaware in the above-entitled cause dated April 16, 1943, that the Securities and Exchange Commission has filed an Application in said Court to enforce and carry out the terms and provisions of a plan, approved by the Securities and Exchange Commission on April 5, 1943, to effectuate the provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 with respect to The United Light and Power Company, and that a hearing will be held before the Honorable District Judge, sitting as Judge of said District Court of the United States, at the United States Court House in Wilmington, Delaware, on the 15th day of June, A. D., 1943, at 10:00 o'clock A. M., Eastern War Time, for the purpose of determining whether the Court should enforce and carry out the terms and provisions of such plan, and whether said plan is fair and equitable and appropriate to effectuate the provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 and for such other purposes as may appear necessary or appropriate in the premises.

[fol. 142] Any person who proposes to oppose the enforcement, or the consummation and carrying out of the terms and provisions of said plan or the approval of the plan by said Court, is required by said order of the Court to serve, on or before June 1, 1943, on John F. Davis, Solicitor, Securities and Exchange Commission, 18th and Locust Streets, Philadelphia, Pennsylvania, and on T. K. Humphrey, General Counsel, The United Light and Power Company, 105 W. Adams Street, Chicago, Illinois, copies of the written statement of such objections and shall file such statement on or before such date with the clerk of said District Court of the United States. Such statement of objections shall be addressed to the Commission's application to said Court and to its findings as set forth in Exhibit C to said application, and shall state in detail, and in the manner required for pleadings by the Rules of Civil Procedure, the extent to which such statement challenges the allegations and findings therein contained, together with any affirmative defenses or objections to said application.

The United Light and Power Company, by William G. Woolfolk, President.

April 21, 1943.

[fol. 143] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1943

No. 8463

In the Matter of the Application of SECURITIES AND EXCHANGE COMMISSION to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 With Respect to The United Light and Power Company.

OTIS & Co., Intervening Preferred Stockholder, Appellant

MINUTE ENTRY—December 23, 1943

And afterwards, to wit, the 23d day of December, 1943, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable John Biggs, Jr., Honorable Charles Alvin Jones and Honorable Gerald McLaughlin, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 20th day of April, 1944, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

[fol. 144] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1943

No. 8463

In the Matter of the Application of SECURITIES AND EXCHANGE COMMISSION to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 With Respect to THE UNITED LIGHT AND POWER COMPANY

OTIS & Co., Intervening Preferred Stockholder, Appellant

On Appeal from the United States District Court for the District of Delaware

Before Biggs, Jones and McLaughlin, Circuit Judges

OPINION OF THE COURT—Filed April 20, 1944

By BIGGS, *Circuit Judge*.

The appeal at bar presents for our determination the question of the meaning of the phrase "fair and equitable"

contained in Section 11(e) of the Public Utility Holding Company Act of 1935, 15 U. S. C. A. §79k(e). In view of the exhaustive opinion of the Commission,[1] those of its con- [fol. 145] curring and dissenting members and that of the District Court [2] it is unnecessary to include here an extended statement of facts for the questions before us are primarily those of law.

The United Light and Power Company, a solvent registered holding company, a Maryland corporation, is at the top of The United Light and Power Company system.[3] Immediately below "Power" is another registered holding company, The United Light and Railways Company. Most of the operating subsidiaries of the system are controlled by "Railways" and Power owns all of its common stock. The Commission has found that Power must be liquidated and dissolved in order to simplify the holding-company system as required by Section 11b (2) of the Act, 15 U. S. C. A. § 79k(b) (2). Power has three classes of stock; a class A common, a class B common, and a class A preferred stock, the last being entitled to cumulative dividends. No issue is presented by the present review as to the rights of the common stockholders vis-a-vis each other. It is unnecessary, therefore, to describe these stocks except to say that the B common carries all voting rights in the company. Power's charter provides that on the dissolution or liquidation of the corporation whether "voluntary or involuntary" the holders of the preferred stock "shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned) including the full dividend for the then current quarterly period, before any payment is made to the holders of any stock other than the * * * [preferred] stock in accordance with their rights at the time of distribution."

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[1] See SEC Holding Company Release No. 4215.

[2] See 51 F. Supp. 217.

[3] There were fifty-two companies included in the system at the time of the hearings before the Commission. Seven of them were registered holding companies.

It is conceded that upon dissolution or liquidation of Power the preferred stock would have a principal claim of [fol. 146] $60,000,000[4] and that accumulated unpaid dividends, as of December 31, 1942, amount to $38,700,000, a total of $98,700,000. Power's principal asset consists of common stock of Railways.[5] It is also conceded by all the parties that the value of Railways' common stock does not amount to $98,700,000.[6] Power and Railways none the less submitted to the Commission joint applications and declarations for the approval of a plan which provided that the common stock of Railways should be distributed to the preferred and common stockholders of Power in the respective ratios of 91.2% and 8.8% and that Power should then be dissolved. The Commission held a hearing on this plan and issued an opinion disapproving the proposed allocation of Railways stock as too generous to Power's common stockholders, but found, Commissioner Healy vigorously dissenting, that a distribution of 94.5% and 5.48% to Power's preferred and common stockholders respectively would be fair and equitable. The plan was modified to accord with the Commission's opinion, was then approved by the Commission and was brought on for hearing before the District Court for the District of Delaware as provided by Section 11(e) of the Act.[7] The court found that the plan was "fair and equitable" and entered an order approving it. The appeal at bar was taken by Otis & Co., a preferred stockholder,

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[4] The preferred stock issued and outstanding consists of 600,000 shares. These shares were issued in 1929 and 1930.

[5] Power has other assets which are to be used by it under the plan for the liquidation of certain obligations. The details of this part of the plan need not be set out here.

[6] Judge Leahy stated, 51 F. Supp. at p. 221:

"If the dividend claim is capitalized as a matured obligation, the total claim of preferred will be $98,700,000. All parties agree also that the assets * * * have not a present value equal to that amount. If the contractual preferences are operative it is clear there will be nothing for the common shareholders."

[7] In Commonwealth & Southern Corp. v. Securities and Exchange Com'n, 134 F. (2nd) 747, 751, we pointed out the function of Section 10(e) in carrying out the scheme of the Act.

which had intervened in the proceedings before the District Court.

Certain apparent concessions made by the appellant disappear on examination. The Commission states in its brief that the only question which Otis & Co. has raised is the [fol. 147] legal theory governing the allocations of the stock of Railways. This is not so in fact. In its brief the appellant "incorporates" and asserts the views of Commissioner Healy as set out in his dissenting opinion and those views cover almost every aspect of the case. The appellant therefore makes two major contentions which may be summed up as follows. First, it takes the position that the Commission is without authority to allocate to the common stockholders of Power any stock of Railways because the total value of that stock is insufficient to pay in kind the amount of the claims of the preferred stockholders of Power [8] as they will mature upon the liquidation of Power; that the phrase "fair and equitable" [9] being one of art, requires the application of the "absolute priority" rule of Case v. Los Angeles Lumber Co., 308 U. S. 106,[10] and forbids

[8] The common stock of Railways, for reasons which need not be gone into in this opinion, is the only asset which Power will have available for distribution to its stockholders upon its dissolution. See note 5 *supra*.

[9] The standard "fair and equitable" set out in Section 11(e) is verbally the same as the standard applicable to plans of reorganization under the various provisions of the Bankruptcy Act. See Sec. 77(e), 11 U. S. C. 205(e); former Sec. 77B(f), former 11 U. S. C. 207(f); Chapter X, Secs. 174 and 221(2), 11 U. S. C. 574 and 621(2); Chapter XI, Sec. 366, 11 U. S. C. 766; Chapter XII, Sec. 472, 11 U. S. C. 872; Chapter XIII, Sec. 646, 11 U. S. C. 1046.

[10] Mr. Justice Douglas in the cited case stated, inter alia, 308 U. S. at p. 115, "The words 'fair and equitable' as used in § 77B(f) are words of art which prior to the advent of § 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations. Hence, as in case of other terms or phrases used in that section, Duparquet Huot & Moneuse Co. v. Evans, 297 U. S. 216, we adhere to the familiar rule that where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary. Keck v. United States, 172 U. S. 434, 446."

the giving of any interest whatsoever to the common stockholders of Power. In other words when the bourne or goal of liquidation or dissolution of Power is reached, says the appellant, the preferred stockholders' rights will mature and they will become entitled to all the common stock of Railways. Second, the appellant asserts that the allotment to Power's common stockholders of an interest of 5.4% cannot be justified by Railways' earnings, or by those of the system, by the present value of Railways stock or in any other way. This last contention necessarily involves some [fol. 148] discussion on our part of Power's earnings as well as those of the system.

The position of the Commission cannot be stated as briefly. It has found that "The assets of Power are * * * of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000 as of December 31, 1942." The Commission points out that Railways' balance sheets indicate a pro forma book value of $77,954,874 for Railways' common stock on a corporate basis and $81,554,330 on a pro forma consolidated basis and states categorically that the "present book values of assets pro forma are clearly insufficient to cover the liquidation preferences of Power's preferred stock. Similarly, on the basis of a capitalization of reasonably anticipated earnings of the enterprise we are unable to find an over-all value for the assets which approaches $98,700,000." The Commission finds that, "If the amount of the liquidation preference of the preferred stock ($100 per share plus accumulated dividends) is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common."

How then can the Commission reach the conclusion, in view of the Los Angeles Lumber Co. case, that Power's common stockholders may receive an interest of 5.48%? This question may be answered as follows. The Commission asserts that while the type of liquidation contemplated in the case at bar is "involuntary" it is of a type that could not have been foreseen by the draftsman of Power's charter or by the investors in its stock. Next, it points out that in the Los Angeles Lumber Co. case and in North Pacific Railway Co. v. Boyd, 228 U. S. 482, financial disaster had

overtaken or threatened to overtake the corporate enterprises and that therefore reorganization securities had to be distributed among creditors and other claimants according to their contractual rights, determined as in liquidation; that in contrast Power is a company virtually without debt or financial embarrassments; that its existence is proscribed [fol. 149] by the Public Utility Act of 1935 and because of this fact Power's stockholders are prevented from maintaining their interests in a going concern; that for these reasons the "stockholders affected should be given participations according to their contractual or other rights, determined *as though in a continuing enterprise*, and that the process of compliance with the statute should not be permitted to mature liquidation preferences • • • [and that] the measure of participation allowed should compensate for the substantive rights of security holders as they would exist apart from the reorganization • • •". The Commission states that in giving effect to the congressional mandate it should not allow the fact of liquidation "• • • to add value to one class of securities at the expense of another class." The Commission concludes that "Where simplification of a system is to be attained through elimination of an unnecessary corporate entity, it is our opinion that the 'fair and equitable' standard does not require us to consider liquidation rights as having matured, and as the sole measure of participation for the preferred stockholders; and it should be immaterial whether the simplification process takes the form of recapitalization, merger or distribution of the assets of a holding company in liquidation. In other words, the 'fair and equitable' standard requires the same recognition of substantive rights irrespective of the method employed in a particular case for obtaining the objectives of Section 11(b) (2)."

The Commission then asserts that "• • • if a class of preferred stock has a measurable interest in an enterprise absent the maturing of liquidation preferences and a proportionately greater interest upon the maturity thereof, it would not be fair or equitable under the statute to give recognition to the greater interest at the expense and to the detriment of the common stock. And conversely, if the common stock has a measurable interest apart from the maturing of liquidation preferences, we must not sanction the destruction of that interest through the operation of the

statutory mandate." Referring specifically to the intent of Congress the Commission finds " * * * that the tech- [fol. 150] niques employed under Section 11 should be those necessary to remove the holding-companies' concentration of economic power over operating utilities and * * * benefit investors generally by giving them more direct interests in the operating properties and earnings to the extent that their holding-company securities represent any real equity therein." The Commission concludes, therefore, that it must judge " * * * the fairness of the plan according to legitimate investment values existing apart from the duty of liquidation imposed by the statute" and that the liquidation preference enters into the question of what is fair and equitable only as "* * * one of the bundle of rights belonging to the preferred stock and affecting its normal value"; that preferences may not be permitted to operate so as to be conclusive in the division of assets between the preferred and common stocks to "accelerate the arrearages and translate them into matured claims at their full face amount, so as to entitle the preferred stock not only to all the assets but also in perpetuity to the entire earning power of those assets," a result which would enrich the preferred at the expense of the common. Fair and equitable compensation will be given to all of the claimants, asserts the Commission, "if their rights are measured not in terms of the situation created by the statute but rather in terms of the situation terminated by it—i. e., as though no liquidation were to take place."; that only in this way can each class of stock be accorded " * * * its proportionate share of the benefits to be gained from the elimination of a useless and expensive corporate entity and from the receipt of a security representing a more direct investment in the underlying assets and earnings of the system."

As to valuation the Commission states that " * * * it is unnecessary to arrive at any specific over-all value for the enterprise or for the preferred and common stocks of Power.", but that it is required "to examine into the respective existing interests of the preferred and common stockholders in the earnings of the enterprise."; that the valuation of the respective interests of preferred and common stockholders cannot be "an exact science" under the [fol. 151] circumstances of the case at bar and that the best it can do is to determine " * * *what assumptions

are necessary to arrive at the allocation, and ascertain whether such assumptions fall within the permissible limits of reasonableness."

The Commission then embarks upon a discussion of the corporate and consolidated net income per books applicable to the preferred and common stock of Power, the preferred dividend requirements and the balance of consolidated net income applicable to Power's common stock from the period from 1929 through 1942. A tabulation is attached to the Commission's opinion and we have reproduced this below.[11] The tabulation shows that Power's corporate [fol. 152] income has not met the dividend requirements of the preferred stock since 1932 but that the consolidated (system) earnings for the same period produced a net balance applicable to the common stock. The Commission points out, however, that it has not been advisable in the past to pass up any substantial part of consolidated earn-

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Years Ended December 31	System Net Income Before Power's Preferred Dividend Requirements		Power's Preferred Dividend Requirements	Consolidated Balance (Deficiency) Applicable to Common Stock of Power
	Corporate	Consolidated		
1929	$2,663,602	$9,971,641	$2,469,505 (a)	$7,502,136 (b)
1930	6,212,264	10,462,450	3,568,613 (a)	6,893,837 (b)
1931	6,956,991	7,819,382	3,600,000 (a)	4,219,382 (b)
1932	4,582,947	4,171,925	3,600,000 (c)	571,925
1933	1,233,591	1,510,925	3,600,660	(2,089,075)
1934	663,188	986,719	3,600,000	(2,613,281)
1935	311,268	2,411,652	3,600,000	(1,188,348)
1936	121,851	4,508,261	3,600,000	908,261
1937	402,139	5,182,602	3,600,023	1,582,602
1938	627,594	3,091,508	3,600,000	(508,492)
1939	2,342,432	4,598,654	3,600,000	998,654
1940	2,365,832	5,266,602	3,600,000	1,666,602
1941	930,813	4,134,544	3,600,000	534,544
Total of 13 yrs.	$29,414,512	$64,116,865	$45,638,118	$18,478,747 (e)
1942 Estimated	1,200,000	6,700,000 (d)	3,600,000	3,100,000
	$30,614,512	$70,816,865	$49,238,118	$21,578,747

a Preferred dividend paid during these years.
b During these years the following common stock dividends were paid:

1929	$1,841,937
1930	3,441,262
1931	3,469,597

None thereafter.

c $900,000 or one-fourth of the annual requirements was paid in 1932.
d Before provision for $160,000 fixed charges on Power's debentures paid on May 1, 1942.
e In contrast, the consolidated surplus at December 31, 1941 was $2,000. The reduction has resulted from the provision for and the elimination of losses during past years.

ings to Railways or to Power and that these earnings have fluctuated widely over the fourteen-year period covered by the tabulation. But it is apparent none the less, that consolidated earnings during the ten years from 1932 through 1941 have come close to equalling the preferred dividends requirements. Also set out in the Commission's opinion is another table, reproduced in part in the footnote below.[12] This tabulation shows the comparative consolidated net income applicable to Railways common stock for the year 1937 through 1942. This includes a statement of earnings [fol. 153] for 1942, based on nine months' actual operations and three months' estimated operations. The table shows that consolidated earnings applicable to the common stock of Railways, subject to certain adjustments which need not be set out here, averaged in excess of $6,000,000 for the five year period from 1937-41 inclusive and about $6,184,000 for the six year period from 1937-42.

Having before it the contents of these tables as well as evidence offered by one of Power's officers as to management's estimates of future earnings the Commission stated, "For the purpose of determining the existing rights of the

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The United Light and Railways Company

Comparative Consolidated Net Income Applicable to Railways' Common Stock for the Years 1937 through 1942

Period	Consolidated Net Income of Power Before Power's Preferred Dividend Requirements	Amount Applicable to Common Stock of Railways Adjusted for System as Constituted at April 30, 1942	Adjustments for Non-recurring Expenditures Netted for Income Taxes	Adjusted Consolidated Balance Applicable to Common Stock of Railways
1937	$ 5,182,602	$ 5,856,311	$ 556,643	$ 6,412,954
1938	3,021,508	3,962,314	749,095	4,711,409
1939	4,598,654	5,118,375	922,575	6,040,950
1940	5,266,602	5,772,567	1,091,483	6,864,050
1941	4,134,544	4,906,879	1,064,738	5,971,617
Total of 5 years	$22,273,910	$25,616,446	$4,384,534	$30,000,989
1942 (9 mos. actual; 3 mos. est.)		6,874,277	232,012	7,106,289
Total of 6 years		$32,490,723	$4,616,546	$37,107,269
5 year average (1937–1941, incl.)		$ 5,123,289	$ 876,907	$ 6,000,196
6 year average (1937–1942, incl.)		5,415,120	769,425	6,184,545

preferred and common stocks in the enterprise, we have assumed earnings of $6,185,000, the average adjusted consolidated income applicable to Railways' common stock for the period 1937-42. However, it must be pointed out that in view of the actual earnings experience and the intangible factors discussed, this figure must be regarded as a very liberal assumption as to earning power." If the $6,185,000 annual consolidated earning figure be adopted, it will, as the Commission points out, require approximately fifteen years for the preferred dividend arrearages to be paid in full, even if all consolidated net earnings be applied to the payment of current and accumulated preferred dividends. In this connection the Commission stated, "* * * it is recognized that at best the interest of the common stock in earnings is remote. Particularly is this true, since, as a practical matter, all consolidated earnings would not be available for disbursement to the preferred and common stockholders. The remoteness of the common stock's participation is also demonstrated by the fact that actual earnings have fluctuated substantially and have never in the past ten years exceeded the figure we are assuming except in 1942." The Commission then concluded, as we have stated, that it could not find that the proposal to allocate 8.8% of Railways stock to Power's common "falls within the permissible limits of reasonableness for a situation of this kind," but found upon consideration of all the circumstances that the "* * * common stock is nevertheless entitled to some participation.", and that "* * * a [fol. 154] participation for the common of approximately 5%, while representing the maximum, would not exceed the permissible limits of fairness, and to secure our approval the plan must be modified to reduce the common stockholders' participation accordingly." [13]

We have quoted at length from the findings and opinion of the Commission because the principles involved in the case at bar are of great public importance and it is necessary for the purposes of this opinion to show the basis of the Commission's decision. It will be observed that the theory of priorities first elucidated by the Commission in Community Power & Light Co.[14] and developed further in

[13] Upon modification as suggested, the Commission adjudged the plan to be "fair and equitable."

[14] 6 S. E. C. 182.

Federal Water Service Corp.[15] has been modified at least by inference by the Commission's decision in the case at bar.[16] There seems to be an unmistakable implication in Federal Water Service Corporation that contractual priorities of preferred stock, no matter how matured, when [fol. 155] matured must be respected. This issue, however, was not squarely before the Commission in Federal Water

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[15] 8 S. E. C. 893.

[16] See also Puget Sound Power & Light Co., S. E. C. Holding Co. Release No. 4255 (April 28, 1943); Southern Colorado Power Co., S. E. C. Holding Co. Release No. 4501 (August 24, 1943); and Virginia Public Service Co., S. E. C. Holding Co. Release No. 4618 (October 16, 1943). It should be noted that the Commission's decision in Community Power & Light Co. followed the decision of the Supreme Court in the Los Angeles Lumber Co. case by twelve days but that that decision was not referred to in the Commission's decision in Community Power & Light Co. In Federal Water Service Corp. a majority of the Commission agreed with Commissioner Healy "that the absence of imminent liquidation cannot justify a plan as being fair and equitable * * * which destroys the contractual priorities of the preferred." The Commission went on to state, "The difference between our views and * * * [those of Commissioner Healy] is that we consider that the contractual rights of the preferred are substantially different where liquidation is not in the atmosphere. We hold that, in such instances, the preferred is being deprived of nothing to which it is entitled. Where liquidation has not been proposed and need not be compelled a liquidation right is merely one of the bundle of rights which imparts value to a security. Absent liquidation, the liquidation preference of a senior class of stock is only an inchoate right to a future payment, which has no definite maturity date, and which will not mature into a present claim despite failure to pay dividends. In addition to this inchoate right to a liquidation preference, the senior stock has present rights to current and accumulated dividends. This right, however, is not absolute, as is a creditor's right to interest; it is only a relative right vis-a-vis junior classes of stock. These junior classes, conversely, have rights vis-a-vis the preferred stock."

Service Corporation since liquidation was not contemplated. It should be noted that the Commission in the instant case contends that it has in fact applied the "fair and equitable" standard prescribed by Section 11(e) and has not deviated from the substance of the interpretation of that standard by the Supreme Court in the Los Angeles Lumber Co. case. In its order approving the plan as modified it specifically found the plan and its proposed allocation to be "fair and equitable."

Is the Commission's determination correct? We are of the opinion that it is. We think that the essence of the Los Angeles Lumber Co. case is contained in the statement by Mr. Justice Douglas, 308 U. S. 118, that the phrase "fair and equitable" has become "a term of art used to indicate that a plan of reorganization fulfilled the necessary standards of fairness." In Group of Investors v. Milwaukee R. Co., 318 U. S. 423, 565-566, Mr. Justice Douglas stated for the Supreme Court that "It is sufficient that each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered." In other words the rights of security holders are to be weighed as exactly as the circumstances permit. If it were possible therefore in the case at bar to arrive at the precise equivalents of the rights of the security holders by the employment of a mathematical formula, the answers given by the exercise of that formula would have to be fulfilled precisely as to each class of security holders in order that the plan of reorganization might achieve the standard "fair and equitable." Each security holder must be compensated as exactly as he can be for that which he is giving up. But though his cup must be filled level to the brim, it must not run over. This much is plain.

There is a vital difference, however, between a 77B or a Chapter X reorganization and that proposed in the case at bar. That difference lies in the fact that the [fol. 156] obligation to pay to the preferred stockholder $100 and accrued dividends on each share of his stock has not matured. It has not matured because the condition of liquidation prescribed by the charter of Power has not occurred. But that condition, says the appellant, will occur, and therefore the rights which accrue to the preferred stockholders on liquidation must be treated by the Commission and by the courts as having accrued already.

Herein we think lies the fallacy of the appellant's argument. Though the preferred stockholders of Power have contract rights which entitle them to the payment of $100 a share and accumulated dividends on liquidation or dissolution of Power, those rights, at least in the absence of insolvency, have not matured and cannot mature for the reason that the congressional mandate contained in the Act strikes across contract rights and the maturities embraced by them, severing them. Though severed, they are not lost for, as we have seen, they must be transmuted as nearly as can be into their equitable equivalents.[17]

As was pointed out by the Circuit Court of Appeals for the Second Circuit in New York Trust Co. v. Securities and Exchange Com., 131 F. (2nd) 274, 276,[18] "Where, through no fault of either party, something necessary for the continued performance of a contract goes out of existence because of some unforeseen circumstance and none of the parties have assumed that risk the contract is regarded as charged with the implied condition that if what is necessary to performance becomes unavailable the contract is no longer binding and further performance is excused." The fundamental doctrine cited is applicable in the [fol. 157] instant case. The contracts between Power and its stockholders and the contracts between the stockholders *inter sese* have come to an end because Congress has decreed it. The corporation no longer possesses the power to perform its contract with its preferred stockholders. The corporation therefore is no longer bound to the performance of

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[17] Such a situation arising under the Public Utility Act of 1935 is analogous to those which have frequently arisen under the Anti-Trust Acts where contract rights must be set aside in order to effectuate the judgment of the contract and to avoid the continuation of the prohibited monopoly. See such cases as Ethyl Gasolene Corp. v. United States, 309 U. S. 436, 455-456; United States v. Int. Harvester Co., 274 U. S. 693, 704-705. Cf. United States v. Reading Co., 226 U. S. 324, 357-358, and Eastern States Lumber Ass'n v. United States, 234 U. S. 600, 606.

[18] The Court affirmed the Commission's ruling that Power should not be compelled to pay off the holders of its debentures at a premium because they had been called prior to maturity despite a contract provision to that effect.

that contract and the preferred stockholders are no longer entitled to its performance. This does not mean, however, that the value of the preferred stockholders' rights must not be transmuted into their equitable equivalents, but if that is done, the plan of reorganization must be deemed to be fair and equitable within the ruling of the Los Angeles Lumber Co. case.

Since the fundamental standard prescribed is that of fairness, the Commission correctly has treated the acceleration right of the preferred stockholders as one to be weighed with all other rights in arriving at the determination of what is fair for the preferred and common stockholders of Power. To permit the preferred stockholders of Power to take all of the common stock of Railways because as an incident in the plan for the simplification of the holding-company system their preferences are to be deemed to be matured would be to bestow a windfall on the preferred stockholders. The fact that the dissolution and liquidation of Power is to be effected under the congressional mandate imposed by Section 11(b) (2) of the Public Utility Act of 1935 instead of those imposed by Section 77B or Chapter X of the Bankruptcy Act is of particular significance for the reason stated but because of other considerations as well. First, it was the intention of Congress in enacting the Public Utility Act of 1935 to preserve the values of securities and not to destroy or diminish their values. The legislative history of the Act makes this clear [19] Congress did [fol. 158] not intend that maturities of securities should be

[19] Reference was made to the techniques developed by the courts in applying the Sherman Anti-Trust Act and the Commodity Clause of the Hepburn Act. These were referred to as permitting "* * * readjustments and reorganizations, without the acceleration of indebtedness or the maturing of rights upon liquidation, to enable corporations to rearrange their corporate structures and divest themselves of properties to the extent required to comply with Government policy." See H. R. Rept. 1318, 74th Cong., 1st Sess. at pp. 49-50, and the "Additional views" of Congressman Eicher, appended to the House Report to accompany S. 2796. Congressman Eicher cited the case of Continental Company v. United States, 259 U. S. 156, 171, in which the Supreme Court stated, "The power of the Court under the Sherman Anti-Trust Law to disregard the letter and legal

accelerated to give any creditor or stockholder a special position to the detriment of any other party in interest in the corporate enterprise. We come therefore to the legal question [20] whether the plan here in issue is "fair and equitable" within the meaning of that phrase as used in Section 11(e).

We think that it is. In making this statement we do not arrogate to ourselves the functions of the Commission or of the District Court. Our jurisdiction is prescribed by Section 25 of the Act, 15 U. S. C. A. § 79y, as was that of the District Court. The learned District Judge specifically approved the plan as "fair and equitable".[21] Section 24(a), 15 U. S. C. A. § 78y, provides that "The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." This court cannot make findings and review the evidence as if *de novo*. But, if we were entitled to do so, we would find that the plan was "fair and equitable" for reasons closely akin to those given by the Commission and by the District Court.[22] Those reasons are set out in the following paragraphs.

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effect of the bonds and general mortgage under the circumstances of this case, in order to achieve the purpose of the law we cannot question."

The President of the United States in his message to Congress of March 12, 1935 stated that the measure "* * * would not destroy a penny of actual value of those operating properties which holding companies now control and which holding companys' securities represent insofar as they have any value." See S. Rept. 621, p. 2, 74th Cong., 1st Sess.

[20] See Case v. Los Angeles Lumber Co., 308 U. S. at p. 119.

[21] The court, as did the Commission, also found the plan appropriate to effectuate the provisions of Section 11. No one doubts that appropriateness.

[22] We conclude that the decision of the Supreme Court in Securities and Exchange Commission v. Chenery Corp., 318 U. S. 80, is not precisely apposite. See Judge Leahy's opinion, 51 F. Supp. at p. 225. In the Chenery case the Commission was dealing with the standard "fair and equitable" as applicable to trading by the management in the course of the reorganization. The language of Mr. Justice Frankfurter, however, shows the general approach of the Supreme Court to the problems presented by the Act

[fol. 159] What the Commission has done is to capitalize the chances of the common stockholders of Power to receive some value for their present interest in a going utility system. As is pointed out in the Commission's brief, absent reorganization, the preferred stockholders of Power are entitled to receive an annual dividend of $3,600,000 and they are entitled to receive all earnings in excess of that amount until the accrued dividends amounting to $38,700,000 were paid off. The Commission has estimated that a fifteen year period will be required at best to reduce the arrearages of dividends to zero. After the payment of arrearages the preferred stock would receive only $3,600,000 a year and the net annual earnings would be available for the common stock. The Commission arrived at the figure of $6,185,000 per year as its estimate of annual average earning power on a consolidated basis, but stated that this was "a very liberal assumption". It must be discounted accordingly. If the plan be carried out the preferred stockholders will give up about 5% of their exclusive claim to all of the income for a fifteen year period and 5% of their exclusive right to the first $3,600,000 of income earned thereafter. In exchange they receive a new right to 95% of the annual earnings in excess of $3,600,000, which the Commission has estimated at $2,585,000, to begin after the fifteen year period and to run as long as the system shall endure.

The Commission in its brief expresses this exchange of rights in other terms as follows. The common stockholders are giving up 100% interest in an estimated $2,585,000 annually which will begin in about fifteen years. In exchange for that right they will acquire a present 5% interest in annual earnings of $6,185,000 a year. This amounts to $309,250. The difference between $2,585,000 and $309,250, which is a ratio of about 8.4 to 1, demonstrates the extent to which the Commission weighted Power's common stockholders' allocation of the common stock of Railways in order to [fol. 160] recognize the elimination of the fifteen year delay as well as the $3,600,000 annual preference of the preferred stockholders. The Commission clearly recognized the risk that earnings available for distribution might be less than $6,185,000 a year. But for the element of risk the relationship between the future interests surrendered and the present interests to be received under the plan may be com-

pared to the difference between an annuity of $8.40 beginning fifteen years hence and an annuity of $1. a year beginning immediately. To make these annuities mathematically equivalent, the annuity of $8.40 a year would be subjected to discount to present value at the rate of 15.2% a year.

Thus, as the Commission points out, 15.2% measures the risk factor upon which the Commission based the assumption that the common stock might receive an estimated $2,585,000 a year beginning fifteen years in the future. This is a very high discount rate and expresses adequately the risk inherent in the expectation that the Commission's earnings estimate will be realized. In employing this high measure of risk factor the Commission offsets its very liberal estimate of $6,185,000 of consolidated earnings.

We think that it is apparent that the consolidated earnings of the system, absent or with reorganization, will run far in excess of the annual dividend requirements of the preferred stock of $3,600,000 a year. While the amount of accrued dividends is substantial and may not be liquidated within the fifteen year period estimated by the Commission, it is none the less apparent that the accumulated dividends will be liquidated at some future time if the system remains in business as a going concern. We cannot say that the liberal estimate of system earnings arrived at by the Commission is too liberal. That question is and must be one which remains within the expert administrative judgment of the Commission. We can and do say that in our opinion the common stockholders of Power cannot be cut out of participation in the system earnings and the plan be deemed to be fair and equitable.

[fol. 161] But, the appellant will assert in answer that the preferred stockholders of Power are entitled to all of the earnings of Power and *vice* Power to all of the earnings of Railways until they have received their arrearages of dividends. It is true that the common stockholders of Power might be given some form of participation which would entitle them in the future to all of the earnings above the preferred stockholders' dividend requirements when the arrearage of preferred dividends had been paid in full. The rights of the preferred stockholders could be limited accordingly. This, however, would introduce into a public utility holding company financing a kind of "security" of

no present value market-wise and of a type which experience has proven to be undesirable. The final answer is that the Commission did not see fit to adopt such a plan and no one has suggested it. Under the plan the preferred stockholders of Power acquire immediate control of the holding company system, a 95% interest therein, and an immediate right to the payment of dividends. This seems to us to be the equitable equivalent to the rights which they are giving up. That most of them think so is evident from the fact that with the exception of the appellant, which holds ten shares of the preferred stock, none has seen fit to appear in the District Court in objection to the plan. As the Commission has found, the allowance of about 5% of the common stock of Railways to the common stockholders of Power does "not exceed the permissible limits of fairness * * *". In the absence of an exact measuring stick or a mathematical formula, neither of which are available, it is our opinion that the Commission is entitled to apply the tests which it has applied and the result which it has reached is sanctioned by the law.

One further point remains to be disposed of. The appellee, Power, insists that the appellant was not a party to the proceeding in the District Court having a right to appeal from that court's judgment. This is based upon the theory that because Otis & Co. did not appear in the pro- [fol. 162] ceedings before the Commission and raised no objection to the plan it had no right to be heard in the District Court. The appellee cites the provisions of Section 24(a) of the Act, 15 U. S. C. A. § 78y, which provides for an appeal to this court by any person aggrieved by an order of the Commission "within sixty days after the entry of such order". Section 11 (e) as we have seen provides for a hearing before the district court after notice and opportunity for hearing. Briefly, the appellee takes the position that it was the intention of Congress to provide for judicial proceedings under Section 11 (e) only in aid of the enforcement of the Commission's order which should be subject to judicial review by the court of appeals and that the issues before the District Court should have been so limited. Power asserts that it was not the intention of Congress to provide for a full judicial review as — the validity of an order in a proceeding before the District Court. Such in the view of the appellee, is a "summary proceeding."

We cannot agree with this interpretation of the statute. While it is clear that Section 24(a) gives the circuit courts of appeals jurisdiction to review any order issued by the Commission upon the application of a party aggrieved thereby, it is equally clear that Section 11(e) contemplates that any person affected by the plan shall have the right to be heard as to whether or not the plan is fair and equitable and appropriate to effectuate the provisions of Section 11. In Commonwealth and South. Corp. v. Securities and Exch. Com'n, 134 F. (2nd) 747, 753, we indicated that stockholders whose rights were affected by an order of the Commission directing a public utility holding company to change its corporate structure had a right to be heard in that district court of the United States in which the Commission was seeking to effect its order; that otherwise those stockholders would be deprived of property without due process of law. It follows that the proceeding before the district court cannot be deemed to be a summary one. Moreover, the fact that notice is to be given [fol. 163] to the persons affected by the plan shows that the theory of submission to the District Court is substantially similar to that required in respect to a plan made pursuant to the provisions of Section 77B or Chapter X of the Bankruptcy Act. True, the issues presented to the District Court are limited to the matters prescribed by the statute but this is the extent of the limitation. Since Otis & Co. was a stockholder it was entitled to be heard. The court below treated Otis & Co. as an intervener, but even if it had not Otis & Co.'s right to appeal in the case at bar would be plain. See the provisions of Section 25 of the Act.

The judgment of the court below is affirmed.

A true Copy: Teste:

—— ——, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 164] In the United States Circuit Court of Appeals for the Third Circuit, October Term, 1943

No. 8463

In the Matter of the Application of Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 With Respect to The United Light and Power Company

Otis & Co., Intervening Preferred Stockholder, Appellant

Present: Biggs, Jones and McLaughlin, Circuit Judges.

On Appeal from the District Court of the United States for the District of Delaware

Judgment—Filed April 20, 1944

This cause came on to be heard on the transcript of record from the District Court of the United States, for the District of Delaware, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

By the Court, John Biggs, Jr., Circuit Judge.

April 20, 1944.

[File endorsement omitted.]

[fol. 165] In United States Circuit Court of Appeals for the Third Circuit

[Title omitted]

Order Amending Opinion—April 26, 1944

Present: Biggs, Jones and McLaughlin, Circuit Judges.

And Now, to wit this 26th day of April, 1944, the printed opinion filed herein on April 20, 1944 is amended as follows:

On page 2, twenty-sixth line from the top thereof, by

inserting the word "such" between the words "of" and "stock," so that the phrase will now read "for each share of such stock."

On page 3, sixteenth line from the top thereof, by striking out "94.5%" and substituting therefor "94.52%" and in the last line of footnote 7, by striking out "10(e)" and substituting therefor "11(e)."

On page 4, last line of footnote 9 thereof, by substituting for the semicolon after "U. S. C. 872;" a period and by striking out the words "Chapter XIII, Sec. 646, 11 U. S. C. 1046" and in lines six and seven of footnote 10 by italicizing [fol. 166] "*Duparquet Huot & Moneuse Co. v. Evans*" and in the last line of footnote 10 by italicizing "*Keck v. United States.*"

On page 7, fifth, sixth and seventh lines from the top thereof, by italicizing the phrase "*to the extent that their holding-company securities represent any real equity therein.*"

On page 9, fifteenth line from the top thereof, by striking out the word "year" and substituting therefor the word "years."

On page 10, twenty-fifth line from the top thereof, by striking out the comma between the words "true" and "since."

On page 11, nineteenth line of footnote 16 thereof, by adding a comma after the word "compelled" and on the second and third lines from the bottom of footnote 16, by striking out the hyphens between "*vis a vis*" and by italicizing the phrase in each instance.

On page 12, nineteenth line from the top thereof, by striking out "423" and substituting therefor "523".

On page 15, thirteenth line from the top thereof, by striking out "§ 78y" and substituting therefor "§ 79x(a)" and in footnote 19, the fifteenth line thereof, by inserting a comma after the word "law" and in the seventeenth line of footnote 19, by striking out the word "would" and substituting therefor the word "will".

On page 19, fourth line from the top, by striking out "§ 78y" and substituting therefor "§ 79x(a)".

For the Court, John Biggs, Jr., U. S. Circuit Judge.

[fol. 167] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 168] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1944

No. 81

[Title omitted]

ORDER ALLOWING CERTIORARI—Filed June 12, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY.

Office - Supreme Court, U. S.
MAY 11 1944
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1943.

No. [redacted].81

OTIS & CO.,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION and THE UNITED LIGHT AND POWER COMPANY,

Respondents.

In the Matter of the Application of Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 With Respect to The United Light and Power Company.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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IN THE

Supreme Court of the United States.

No. . October Term, 1943.

OTIS & CO.,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY,

Respondents.

In the Matter of the Application of Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 With Respect to The United Light and Power Company.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, FOR THE THIRD CIRCUIT.

To the Honorable Harlan Fiske Stone, Chief Justice of the Supreme Court of the United States, and the Associate Justices of the Supreme Court of the United States:

Comes Now, Otis & Co., a corporation of the State of Delaware, and respectfully prays for a Writ of Certiorari to the Circuit Court of Appeals, for the Third Circuit, to review a judgment entered in the above-captioned matter on April 20, 1944.

A certified transcript of the record before the Circuit Court of Appeals at argument, consisting of the appendices to the briefs, and the proceedings in said Circuit Court of Appeals, is presented herewith in accordance with Rule 38 of this Court.

Summary of the Matter Involved.

The judgment which petitioner seeks to review is one wherein the Circuit Court of Appeals, for the Third Circuit, affirmed a final Order entered by the United States District Court, for the District of Delaware, approving a Plan submitted by The United Light and Power Company under Sec. 11 (e) of the Public Utility Holding Company Act of 1935, 15 U. S. C. A. Sec. 79K (e), to comply with the requirements of Sec. 11 (b) of the Act, 15 U. S. C. A. Sec. 79K (b).* The case originated in the District Court on an application of the Commission pursuant to Secs. 11 (e) and 18 (f) of the Act for Court approval and enforcement of the Plan submitted by Power. The Plan makes provision for the liquidation and dissolution of Power by first distributing all of its assets to its preferred and common stockholders on the basis of 94.52% and 5.48% respectively, although the total assets of Power do not have a present value equal to the liquidation preferences of the preferred stock as set forth in the charter. The District Court nevertheless found the Plan to be "fair, equitable and appropriate to effectuate the provisions of Section 11" of the Act and entered an Order directing that it be carried out. Petitioner contends that it is not "fair and equitable" to the preferred stockholders, of which petitioner is one.

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* The Securities and Exchange Commission will be called "Commission." The United Light and Power Company will be called "Power" and the Public Utility Holding Company Act of 1935, 49 Stat. 838, 15 U. S. C. A. Sec. 79, will be called "the Act."

Short Statement of the Matter Involved.

The facts are not in dispute. Power is the top holding company in a large, public utility holding company system. As it is a holding company with subsidiary companies, which are in turn holding companies, Sec. 11 (b) (2) of the Act proscribes its continued existence. The Commission itself took action prior to the filing of the instant Plan to terminate the existence of Power. By Order dated March 20, 1941, the Commission directed that Power "shall be liquidated and dissolved." (Holding Company Act Release No. 2636; R. 139-140.)* The Commission said that the present Plan (R. 112-120a) "is the final step in fulfilling the portion of our Order of March 20, 1941, requiring the liquidation and dissolution of Power" (R. 7a), and then found that the present Plan "provides for the liquidation and dissolution of power." (R. 11a.) The District Court stated: "I accept the findings of the Commission that there is necessity * * * for Power to liquidate pursuant to Sec. 11 (b) (2)." (R. 98a.)

The liquidation provided by the Plan is one which allows the common stock to participate in the distribution of the assets of Power, although the present value of the assets of Power is not equal to the liquidation preferences of the preferred stock. The charter of Power provides that "Upon the dissolution or liquidation of the corporation, *whether voluntary or involuntary*" the holders of preferred stock shall receive $100.00 per share, plus accumulated dividends, "before any payment is made to the holders" of the common stock. (R. 46a.) The Commission first found that the Plan was appropriate to effectuate the provisions of Section 11 of the Act, and then said:

> "The second required finding, namely, that the plan is 'fair and equitable to the persons affected by

*The record presented herewith consists of certified copies of the appendices used below. In the Circuit Court of Appeals petitioner was the appellant.

such plan,' presents a more difficult problem. The assets of Power are, in our opinion, of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942.

* * * * * *

"* * * present book values of assets pro forma are clearly insufficient to cover the liquidation preference of Power's preferred stock. Similarly, on the basis of a capitalization of reasonably anticipated earnings of the enterprise [9] we are unable to find an over-all value for the assets which approaches $98,700,000.

* * * * * *

"* * * In the light of all the circumstances, we conclude that on no reasonable basis for capitalizing prospective earning power could we arrive at a valuation equal to the liquidation preference.

"If the amount of the liquidation preference of the preferred stock ($100 per share plus accumulated dividends) is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common."

(R. 11a-13a.)

The District Court said:

"If the dividend claim is capitalized as a matured obligation, the total claim of preferred will be $98,700,000. All parties agree also that the assets * * * have not a present value equal to that amount. If the con-

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"[9] It is clear that capitalization of prospective earnings, rather than book values, is the principal criterion of asset value. *Consolidated Rock Products v. DuBois*, 312 U. S. 510."

tractual preferences are operative it is clear there will be nothing for the common shareholders.

"The problem for determination is whether the plan is 'fair and equitable'. Concededly, the plan does not satisfy the 'absolute priority' rule which is applied in equity and bankruptcy reorganizations.[4] Under that rule, no plan can be fair and equitable which permits a junior security to retain an interest in the reorganized corporate enterprise before the securities senior to it have been paid in full (but not necessarily in cash) for the rights which they surrender. The value of the reorganized concern is projectively determined by a capitalization of the 'guess' earnings of the new concern and comparing the valuation so arrived at with the total claims of the old senior securities. The present plan fails to meet this test, as junior interests are allowed to participate in the new capital structure of Railways when it is conceded that Railways' common is not worth $98,700,000 on any basis of valuation. *If the claims of the preferred stockholders are to be treated as matured as in an equity or bankruptcy reorganization, there can be no participation for the common stock under the 'absolute priorities' rule.*"

(R. 98a-99a.)
(Italics supplied.)

The Circuit Court accepted the findings of the Commission that "The assets of Power are • • • of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares,

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[4] "Case v. Los Angeles Lumber Products Co., 308 U. S. 106; Consolidated Rock Products Co. v. duBois, 312 U. S. 510; Marine Harbor Properties v. Manufacturers T. Co., 317 U. S. 78; Ecker v. Western Pacific R. Corp. U. S. , and Institutional Investors v. Chicago, M., St. P. & P. R. Co., U. S. ."

plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942." (R. 149.)

Although the Commission, the District Court, and the Circuit Court all accepted the fact that the common stock of Power was "under water" upon every reasonable estimate of the present value of Power's assets, they nevertheless determined that it would be "fair and equitable" to give the common stockholders 5.48% of these assets upon the instant liquidation, which has been forced upon Power to comply with the provisions of the Act. They came to this conclusion by adopting the theory that the present claims of the preferred stock upon the assets of Power *should not be considered as having matured.*

The Commission said:

> "* * * In our view, it is not inconsistent with the bankruptcy and equity precedents to conclude that in reorganizations or liquidations to comply with Section 11, stockholders affected should be given participations according to their contractual or other rights determined *as though in a continuing enterprise*, and that the process of compliance with the statute should not be permitted to mature liquidation preferences." (Italics in text.)
>
> (R. 14a.)

The District Court said in considering this view: "This is a new approach to the problem." (R. 100a.) He followed this new approach, and concluded:

> "* * * the common stockholders should be given a chance to recoup, especially where the reason for liquidation is purely fortuitous, and where the future condition of the new enterprise is based on a surmise."
>
> (R. 101a.)

The Circuit Court in affirming the District Court, said:

> "* * * Though the preferred stockholders of Power have contract rights which entitle them to the

payment of $100 a share and accumulated dividends on liquidation or dissolution of Power, those rights, at least in the absence of insolvency, have not matured and cannot mature for the reason that the congressional mandate contained in the Act strikes across their contract rights and the maturities embraced by them, severing them." (R. 156.)

This new approach has not been before the Courts except in this case, and is one which has divided the Commission. The majority has adopted it. Judge Healy has set forth his views, which are in opposition to the majority, in a vigorous dissent in this case (R. 46a-86a) and in other dissenting and concurring opinions.*

After concluding that the claims of the preferred stock to the assets of Power should not be considered as having matured, the Commission indulged in a guess as to what might happen in the event the enterprise continued, as it might have done but for the passage of the Act proscribing its existence. The Commission guessed that if the enterprise continued, the arrearages on the preferred stock could be discharged at the expiration of 15 years, after which time there would be earnings available to pay dividends on the common stock. Because of the possibility that there might be earnings available to pay dividends on the common stock after 15 years, if the enterprise could have continued uninterrupted by the passage of the Act, the

*International Paper and Power Company, 2 S. E. C. 274, at 285 ff.; Federal Water Service Corporation, 8 S. E. C. 893; Columbia Gas and Electric Corporation, S. E. C. , Holding Company Act Release No. 3885 (1942); Engineers Public Service Company, S. E. C. , Holding Company Act Release No. 4114 (1943); Puget Sound Power & Light Company, S. E. C. , Holding Company Act Release No. 4255 (1943); Southern Colorado Power Company, S. E. C. , Holding Company Act Release No. 4501 (1943); Virginia Public Service Co., S. E. C. , Holding Company Act Release No. 4618 (1943).

Commission determined that the Plan was "fair and equitable" in giving to the common stockholders at the present time 5.48% of the assets, having a value of approximately $4,000,000.00. (See Balance Sheet, R. 5a.)

Petitioner objected below to the approval of the Plan on the ground that it is not "fair and equitable" to give the preferred stockholders less than their full liquidating preferences as called for under the "full or absolute priority" rule established by this Court in *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 60 S. Ct. 1, 84 L. ed. 110.

Statement Disclosing the Basis Upon Which It Is Contended That This Honorable Court Has Jurisdiction to Review the Judgment in Question.

The Statute under which the jurisdiction of this Court is invoked is Section 240 (a) of the Judicial Code (28 U. S. C. A. § 347a).

The date of the judgment sought to be reviewed is April 20, 1944, and the date upon which this petition for Writ of Certiorari is presented is May 10, 1944.

The foregoing Summary and Short Statement of the Matter Involved shows the nature of the case and the ruling of the Court below which brings the case, a civil action, within the jurisdictional provisions relied on. The following cases are believed to sustain the jurisdiction:

Securities and Exchange Commission v. Chenery Corporation, et al., mem. 317 U. S. 609, 63 S. Ct. 52, 87 L. ed. 494; 318 U. S. 80, 63 S. Ct. 454, 87 L. Ed. 626.

Consolidated Rock Products Co. v. duBois, mem. 311 U. S. 636, 61 S. Ct. 71, 85 L. ed. 405; 312 U. S. 510, 61 S. Ct. 675, 85 L. ed. 982.

A. C. Frost & Co. v. Coeur D'Alene Mines Corp., mem. 311 U. S. 624, 61 S. Ct. 9, 85 L. ed. 396; 312 U. S. 38, 61 S. Ct. 414, 85 L. ed. 500.

Electric Bond & Share Company, et al. v. Securities and Exchange Commission, et al., mem. 302 U. S. 681, 58 S. Ct. 411, 82 L. ed. 526; 303 U. S. 419, 58 S. Ct. 678, 82 L. ed. 936.

Federal Trade Commission v. Raladam Co., mem. 282 U. S. 829, 51 S. Ct. 86, 75 L. ed. 738; 283 U. S. 643, 51 S. Ct. 587, 75 L. ed. 1324.

Included in the Record (R. 144 to 167) is a copy of the opinion delivered on April 20, 1944, by the Circuit Court for the Third Circuit upon the rendering of the judgment sought to be reviewed, as corrected by Order dated April 26, 1944.

Questions Presented.

1. Is the instant Plan "fair and equitable" within the meaning of that phrase as used in Sec. 11 (e) of the Act?

2. Are claims of preferred stock to preferences upon an "involuntary" dissolution or liquidation to be considered as matured and a claim upon the assets of a corporation ahead of claims of common stock when in complying with Sec. 11 (b) of the Act a plan for dissolution and liquidation is submitted under Sec. 11 (e) of the Act?

3. Can a plan to liquidate, submitted by a corporation under Sec. 11 (e) of the Act to comply with the requirements of Sec. 11 (b) of the Act, be approved by a District Court as "fair and equitable" which allows junior interests to participate and receive part of the assets before senior securities receive their full liquidation preferences?

4. Is the "full or absolute priority" rule as established in *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, applicable to plans submitted under Sec. 11 (e) of the Act to comply with the requirements of Sec. 11 (b) of the Act?

Reasons Relied On for Allowance of the Writ.

1. The Circuit Court of Appeals erred in holding that the instant Plan is "fair and equitable" to preferred stockholders of Power.

2. The Circuit Court of Appeals pointed out that: "The principles involved in the case at bar are of great public importance" (R. 154), and hence should be finally determined by this Honorable Court.

3. The judgment of the Circuit Court of Appeals that the instant Plan is "fair and equitable" is on an important question of federal law which has not been, but should be, settled by this Honorable Court.

4. The question presented looms large in the administration of the Act by the Commission, as many registered holding companies must take steps to comply with Sec. 11 (b) of the Act by submitting plans under Sec. 11 (e), and the Commission should have a determination by this Honorable Court on the relative rights of security holders to participate in such plans.

5. The question presented is a novel one and clearly of sufficient importance to warrant a determination by this Honorable Court.

6. The interpretation of the meaning of the phrase "fair and equitable" contained in Sec. 11 (e) of the Act by the Circuit Court of Appeals in this case is in conflict with applicable decisions of this Court.

Prayer.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court directed to the Circuit Court of Appeals for the Third Circuit, or, if its mandate has gone down, to the United States District Court for the District

of Delaware, commanding the Court to certify and send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case in said Circuit Court numbered and entitled on its docket "*No. 8463, In the Matter of the Application of Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 with Respect to The United Light and Power Company. Otis & Co., Intervening Preferred Stockholder, Appellant,*" and that the said judgment of the Circuit Court of Appeals for the Third Circuit affirming the Order of the District Court may be reversed by this Honorable Court and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

OTIS & CO.,
Petitioner,

By ARTHUR G. LOGAN,
Continental American Building,
Wilmington 33, Delaware,
Its Attorney.

STATE OF DELAWARE,
NEW CASTLE COUNTY, } *ss.:*

BE IT REMEMBERED, that on this 9th day of May, A. D. 1944, personally appeared before me, the subscriber, a Notary Public for the State and County aforesaid, ARTHUR G. LOGAN, who, being by me first qualified according to law, did depose and say that he is the attorney for the petitioner named in the foregoing Petition; that he has read the foregoing Petition and that the facts set forth therein are true so far as the same relate to his own acts and deeds, and so far as the same relate to the acts and deeds of any other person or persons, he believes them to be true; and that this Petition is not filed for delay.

ARTHUR G. LOGAN.

Sworn to and subscribed before me the day and year first aforesaid.

ANNA R. SILVER,
Notary Public.

(Notarial Seal)

IN THE

SUPREME COURT OF THE UNITED STATES.

No. . October Term, 1943.

OTIS & CO.,

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v.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY,

Respondents.

In the Matter of the Application of Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 With Respect to The United Light and Power Company.

BRIEF FOR PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A concise statement of the grounds upon which the jurisdiction of this Court is invoked is set forth in the foregoing Petition, pp. 8-9, *supra.*

A concise statement of the case containing all that is material to the consideration of the questions presented, with appropriate page references to the printed record, is set forth in the foregoing Petition under the headings Summary of the Matter Involved and Short Statement of the Matter Involved, pp. 2-8, *supra.*

Questions Presented.

1. Is the instant Plan "fair and equitable" within the meaning of that phrase as used in Sec. 11 (e) of the Act?

2. Are claims of preferred stock to preferences upon an "involuntary" dissolution or liquidation to be considered as matured and a claim upon the assets of a corporation ahead of claims of common stock when, in complying with Sec. 11 (b) of the Act, a plan for dissolution and liquidation is submitted under Sec. 11 (e) of the Act?

3. Can a plan to liquidate, submitted by a corporation under Sec. 11 (e) of the Act to comply with the requirements of Sec. 11 (b) of the Act, be approved by a District Court as "fair and equitable" which allows junior interests to participate and receive part of the assets before senior securities receive their full liquidation preferences?

4. Is the "full or absolute priority" rule as established in *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, applicable to plans submitted under Sec. 11 (e) of the Act to comply with the requirements of Sec. 11 (b) of the Act?

Argument.

I. Reasons Relied on for Allowance of the Writ Not Based on Merits of Petitioner's Assertion That Error Was Committed.

A. *The Principles Involved in the Case at Bar Are of Great Public Importance.*

The Circuit Court of Appeals pointed out that: "The principles involved in the case at bar are of great public importance." (R. 154.) The instant matter presents a question of great public importance because of the fact that numerous registered holding companies have submitted, or are about to submit, to the Commission plans under Sec. 11 (e) of the Act to comply with the provisions of Sec. 11 (b) of the Act and the relative rights of security holders of the corporations involved will be adjusted in accordance with the principles announced in the instant case, and hence these principles should be finally determined by this Honorable Court. If not determined by this Honorable Court at an early date, many plans may be submitted improperly adjusting the rights of security holders involving many millions of dollars. In some other circuit at a later date there may be a determination of the matter different from the determination made below, which would leave in chaos the status of the claims of many security holders throughout the United States. In *Electric Bond & Share Company, et al. v. Securities and Exchange Commission, et al.*, mem. 302 U. S. 681, 58 S. Ct. 411, 82 L. ed. 526; 303 U. S. 419, 58 S. Ct. 678, 82 L. ed. 936, this Court granted a Writ of Certiorari in order that there could be a final determination by this Court of certain principles of great public importance brought into existence by the passage of the Act. We submit that the instant question calls for a similar exercise of discretion by this Honorable Court.

B. *An Important Question of Federal Law Is Involved.*

The judgment of the Circuit Court of Appeals that the instant Plan is "fair and equitable" as that phrase is used in Sec. 11 (e) of the Act constitutes a decision on an important question of federal law. As the decision is on an important question of federal law which has not been settled by this Court, this Court should grant the Writ in order to settle the question. In *A. C. Frost & Co. v. Coeur D'Alene Mines Corp.*, mem. 311 U. S. 624, 61 S. Ct. 9, 85 L. ed. 396; 312 U. S. 38, 61 S. Ct. 414, 85 L. ed. 500, a petition for certiorari was granted. This Court said:

> "This action was based wholly on interpretation and application of the Securities Act. Thus a federal question arose which demands determination."

We submit the same reasoning applies here calling for the favorable exercise of the discretion of this Court upon the instant Petition.

C. *The Question Presented Looms Large in the Administration of the Act by the Commission.*

The question presented looms large in the administration of the Act by the Commission, as many registered holding companies must take steps to comply with Sec. 11 (b) of the Act by submitting plans under Sec. 11 (e), and the Commission should have a determination by this Honorable Court on the relative rights of security holders to participate in such plans. In *Securities and Exchange Commission v. Chenery Corporation, et al.*, mem. 317 U. S. 609, 63 S. Ct. 52, 87 L. ed. 494; 318 U. S. 80, 63 S. Ct. 454, 87 L. ed. 626, this Court granted a writ of certiorari to review proceedings originating, as the instant one does, in an Order by the Commission approving a plan. This Court said: "Because the question presented looms large in the administration of the Act, we brought the case here." We submit that the instant case should also be brought up as the question does loom large in the administration of the Act.

D. *A Novel Question Is Involved of Sufficient Importance to Warrant a Determination by This Honorable Court.*

The District Court recognized that the Plan adjusted senior and junior securities in an unorthodox and novel manner. The Court said: "This is a new approach to the problem." (R. 100a.) The District Court took the position that the common stockholders should be given "a chance to recoup." This idea that common stockholders should be given a chance to recoup after their stock is far "under water" when a corporation seeks to comply with the standards of Sec. 11 (b) of the Act is, we submit, a novel one. This Court should review this position and determine whether or not common stockholders in registered holding companies, which must comply with the standards of Sec. 11 (b) of the Act, can have their management formulate and submit plans bottomed on a theory of recoupment of their lost values.

II. Reasons Relied On for Allowance of the Writ Based Upon Error Committed by the Court Below and Going to the Merits of Petitioner's Contentions.

A. *The Judgment Below Made a Determination on a Federal Question in a Way in Conflict With the Applicable Decisions of This Court.*

The determination made by the court below as to the meaning of the phrase "fair and equitable" as contained in Sec. 11 (e) of the Act is in conflict with the determination made by this Court as to the meaning of such a phrase in *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 60 S. Ct. 1, 84 L. ed. 110, where this Court held that the words are words of art, which, in the field of corporate reorganizations, as the instant case in effect is, require the application of the "rule of full or absolute priority." In

Case v. Los Angeles Lumber Products Co. a contention was made substantially similar to the one in this case with respect to the fact that the senior securities involved had not matured. There the contention was that the bonds had not matured and hence the stockholders were in a position "to remain in unmolested domination and control over the property" for a period of time, and, therefore, had an equity which could be recognized in the reorganization by giving the stockholders a participation, even though the stock was "under water." This Court rejected the contention and pointed out that by taking the step to place the corporation in line for reorganization under Sec. 77B, the stockholders had lost the right "to remain in unmolested domination and control over the property" and hence whatever nuisance value may have resided in the stock was lost and the stockholders could not participate. In the instant case the court below has refused to recognize the principle that by taking the step of submitting a Plan to comply with Sec. 11 (b) of the Act and requesting (R. 117a) enforcement through Court supervision under Sec. 11 (c), the right of the common stockholders to remain in unmolested domination and control over the property was lost, *if it had not been lost previously by the passage of the Act itself requiring compliance with the standards of Sec. 11* (b). Thus we find that in the instant case the court below refused to follow the decision of this Court in *Case v. Los Angeles Lumber Products Co.*, clearly applicable, that when plans are formulated and filed to reorganize a corporation, whether by compulsion of statute as involved here, or otherwise, senior rights mature and are entitled to their full and absolute priority before junior rights can participate. Other applicable decisions of this Court not considered and not followed are: *Consolidated Rock Products Co., et al. v. duBois*, 312 U. S. 510 (See discussion *infra*, p. 20), and *Continental Ins. Co. v. United States*, 259 U. S. 156 (See discussion *infra*, p. 23).

Commissioner Healy, dissenting in a vigorous opinion, set forth numerous reasons wherein the Plan is not "fair and equitable" in the light of the applicable decisions of this Court, and petitioner adopts said dissenting opinion and incorporates it herein by reference. It is printed in full in Appellant's Appendix. (R. 46a-86a.) In addition, Commissioner Healy has set forth his views in other dissenting and concurring opinions, to which we respectfully refer this Honorable Court.*

B. *The Circuit Court of Appeals Erred in Holding That the Instant Plan Is "Fair and Equitable" to Preferred Stockholders of Power.*

1. The liquidation preferences matured.

In addition to the views set forth by Commissioner Healy in his dissenting opinion in this case and in his other dissenting and concurring opinions referred to above, which we incorporate by reference and urge, we desire to argue that liquidation preferences of senior securities are matured by any reorganization, liquidation or dissolution which is forced by the Act, and that the normal rule of "full or absolute priority" governs in all such cases.

The Commission and courts below have taken the position that the usual rule of "absolute priority" which is applicable in the case of insolvent corporations, either in the bankruptcy or in the equity sense, is not applicable to any reorganization, liquidation, dissolution, or other proceedings that must necessarily be taken to comply with the

*International Paper and Power Company, 2 S. E. C. 274, at 285 ff.; Federal Water Service Corporation, 8 S. E. C. 893; Columbia Gas and Electric Corporation, S. E. C. , Holding Company Act Release No. 3885 (1942); Engineers Public Service Company, S. E. C. , Holding Company Act Release No. 4114 (1943); Puget Sound Power & Light Company, S. E. C. , Holding Company Act Release No. 4255 (1943); Southern Colorado Power Company, S. E. C. , Holding Company Act Release No. 4501 (1943); Virginia Public Service Co., S. E. C. , Holding Company Act Release No. 4618 (1943).

Act. We do not see how it can be so limited. *What material difference exists between a financial difficulty forcing a bankruptcy and some other difficulty which makes it impossible for the corporate venture to continue?* In *Consolidated Rock Products Co., et al. v. duBois*, 312 U. S. 510, 61 S. Ct. 675, 85 L. ed. 982, this Court said, "the absolute priority rule * * * applied to reorganizations of solvent as well as insolvent companies." (312 U. S. 527.) In the course of corporate history we have seen public policy expressed by Congress and the people in many acts and amendments including the Sherman[a] and Clayton Acts,[b] the National Prohibition Amendment,[c] the Hepburn Act,[d] and now the instant Act to terminate public utility holding companies. All of these affected the destinies of corporations, and terminated the ventures in which they were engaged. The continued existence of any corporation or its business cannot be foreseen or guaranteed. What then is the difference between bankruptcy, reorganization or some other emergency? A public policy expressed in an Act of Congress is now terminating the existence of Power, as it previously had of corporations which had become trusts or were in the liquor business. The passage of the Act marked the ultimate end of Power's existence or at least the end of the business venture in which it was engaged. Liquidation and dissolution now mark the finish line. Whatever the expectancies might have been, the rules of payment at the end, whenever reached, are laid down by the charter. These rules should govern the priority of payment to the respective stockholders regardless of how the end of the venture is reached.

We pointed out above that in *Case v. Los Angeles Lumber Products Co.* the contention was made that as the bonds had not matured when the plan of reorganization

a. 26 Stat. 209, 15 U. S. C. A. Secs. 1-7.
b. 38 Stat. 730, 15 U. S. C. A. Secs. 12-27.
c. 40 Stat. 1050.
d. 34 Stat. 584, 49 U. S. C. A. 1, etc.

was proposed, the stockholders were in a position "to remain in unmolested domination and control over the property" and hence had an equity entitling them to participation. This Court rejected the contention and then pointed out that when the plan was proposed, the stockholders had waived their rights and that, "Certainly the surrender of a right thus waived is not adequate consideration for the dilution of the bondholders' priorities which this plan would effect." In the instant case there is even greater reason to say that the stockholders' right "to remain in unmolested domination and control over the property" does not create an equity entitling the stock to participation, because the Act itself, in Sec. 11 (b), had proscribed the continued existence of the venture, and thus had terminated any such continuing control in the common stockholders. *The very purpose of the Act was to end the domination of great public utility empires by holding companies through the ownership of common stocks representing little or no equity value.*

The Commission and courts below deviated from the normal application of the "absolute priority" rule by concluding that the Act did not mature the claims of the preferred stockholders to their liquidating preferences, on the theory that the matter should be treated "*as though in a continuing enterprise.*" (R. 14a.) They do not treat this as the end. This approach is diametrically opposed to the intention of the Congress in passing the Act.

Prior to the passage of the Act, the preferred and common stockholders of Power had embarked upon a common enterprise to conduct a public utility holding company system with the top company, Power, having for its business the holding of stock in subsidiaries which were in turn public utility holding companies. The Congress determined that such systems had become "injurious to investors, consumers, and the general public." Sec. 1 (c). The Congress declared that it was the policy of the Act "to provide as soon as practicable for the elimination of (such) public-

utility holding companies." Sec. 1 (c). Not only was the policy of the Act set forth as being one to eliminate companies such as Power, but Section 11 (b) (2) directed that steps should be taken to terminate the life of holding companies such as Power. This is the "death sentence" of the Act. In the instant case Power has received its death sentence under the express terms of the Act and under the Order of the Commission of March 20, 1941. (R. 139-140.) The present Plan is intended to administer the death blow required by the law. *It is the end.* The public policy of this country as set forth in the Act and defined by the Congress is that a company such as Power should receive a death blow. As the preferred and common stockholders jointly embarked upon a venture which, by legislative fiat and Commission Order, must end, how can it be said that their respective rights to the assets remaining as defined by the charter, are as in a continuing enterprise? Under the law there is nothing left to do with Power but distribute its assets to those *now* entitled to them, and under the charter those *now* entitled to such assets are the preferred stockholders whose claims must be considered to be completely and fully matured by the termination of the venture. As the venture cannot continue, preferred stockholders are entitled to their contractual rights. The present Plan does not give them their contractual rights and hence is not "fair and equitable" to them.

The Commission and the courts below pointed to the President's message that the Act "will not destroy a penny of actual value of those operating companies which holding companies now control." (R. 158.) We can agree, but the President did not mean by that that the values of preferred stock would be diminished and diluted by allowing the participation of worthless common stock, as the Order below would allow in this case.

Although this "new approach" has not been before the courts except in this case, we do find precedent in a quite similar situation where common stockholders, upon

a forced liquidation and dissolution, contended in effect that in dividing the assets between preferred and common stock, the common stock should be treated as though in a continuing enterprise and not as though upon liquidation. This contention was rejected by this Court. The case is that of *Continental Ins. Co. v. United States*, 259 U. S. 156, at 177-181, 66 L. ed. 871 at 886-888. In that case the Reading Company and certain other companies were found to have formed an illegal combination and a decree was entered "requiring dissolution." This Court in an earlier opinion had remanded the case to the District Court and directed a decree "dissolving the whole combination * * * and such disposition of stocks and bonds and other property of the Reading Company as might be necessary." This was similar to the steps in the instant situation in that a prior Order of the Commission had directed that Power "shall be liquidated and dissolved." The Reading Company proposed a plan under which the assets of one of its subsidiaries, a coal company, were to be transferred to a new corporation and rights to subscribe to the stock of the new corporation were to be offered, share for share, alike to the preferred and common stockholders of the Reading Company. The rights offered were very valuable. Common stockholders objected on the ground that the distribution being made in the form of the rights was in effect a distribution of the surplus of the company, which, in a continuing enterprise, could have been used upon certain conditions to pay common stock dividends and hence it was unfair to divide the surplus between the preferred and the common in accordance with the liquidation provisions of the charter. This Court pointed out that although the rights were to be offered at $2.00 their then quoted market value ranged from $11 to $20, and said:

> "This might have been expected, in view of the disparity between par of the capital stock of the Reading Coal Company and the far greater actual value of its properties. The disparity shows that while the

transfer of certificates of interest in the new Coal Company stock is denominated a sale, *it is only a distribution of the surplus or assets of the Reading Company, to its stockholders, made necessary by the decree of this court* in taking the Reading Company out of the coal business and restricting it to that of owning and operating a railroad system. The Reading Company, by merger with the Reading Railway Company, is made to change its character. Under the plan it must comply with the Act of May 3, 1909, Penn. Laws, 408, by which, in merging with the Reading Railway Company, it becomes a new corporation.

* * *

"*What is to be done is, in fact and law, a liquidation of the assets of the old Reading Company.* Its stockholders receive their distribution in kind by retention of the stock they held in the old Reading Company as stock in the reduced new Reading Company, purged of its offense against the law, together with the distributive values of that which the old Reading Company has been compelled to get rid of: i. e., the ownership of the stock of the Coal Company."

* * *

"*The rights of the common and preferred stockholders of the Reading Company inter sese are to be determined by the organization agreement of 1896.*" (Italics supplied.)

This Court then pointed out that although it might be argued that the surplus could have been used to pay common dividends under certain conditions, the Board of Directors had failed to declare dividends on the common out of such surplus and therefore the surplus was part of the assets of the corporation "as of the time of the compulsory winding up and liquidation of the corporation." This Court then held that, as the charter gave the preferred and common the right to share equally in a distribution of assets upon liquidation, such charter provisions must gov-

ern as there was a liquidation. This Court in effect matured the liquidation rights of both classes of stock upon the "compulsory winding up and liquidation of the corporation."

In the instant case we have a "compulsory winding up and liquidation of the corporation" due to the passage of the Act which declared it to be the public policy of this country that an enterprise such as that engaged in by Power must end. This we submit matured the claims of all classes of stock, and requires treatment in accordance with the liquidation preferences set forth in the charter.

2. The finding of value in the common stock was based on speculation and was not a fact finding and was not a fair and equitable manner in which to determine present values.

We further wish to argue that, even if the respective values of the preferred and common stocks of Power are treated as in a continuing enterprise, still the findings of the Commission as to earnings, and the earnings tables in the record, do not afford a substantial basis for a judicial determination that the preferred stockholders should be deprived of 5.48% of the value of the assets to be distributed.

In order to support the proposition that 5.48% of the value should be taken away from the preferred stockholders the Commission says "we have assumed earnings of $6,185,000.00," and adds that "this figure must be regarded as a very liberal assumption of earning power." The Commission further says, "it is recognized that at best the interest of the common stock in earnings is remote," and that the remoteness is further "demonstrated by the fact that actual earnings have fluctuated substantially, and have never in the past ten years exceeded the figure we are assuming, except in 1942."

Admitting that the chances of the common stock are very remote, and that the assumed earnings are very liberal, the Commission, adopting that liberal assumption, came to the conclusion that it will require approximately 15 years at that rate for dividend arrearages on the preferred to be paid. The courts below accepted this assumption and the conclusion based upon it as a finding of fact. In view of the fluctuations of earnings in the past, and the tremendous uncertainties of the 15 years next to come, a determination that the common stock has a presently recognizable value as high as 5.48% of the assets rests upon a theoretical speculation, which does not adequately support a judicial determination.

Conclusion.

It is respectfully urged that the Writ of Certiorari prayed for in the foregoing Petition be granted.

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IN THE

Supreme Court of the United States

October Term, 1944.

No. 81.

OTIS & CO.,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION and THE UNITED LIGHT AND POWER COMPANY,

Respondents.

BRIEF FOR PETITIONER.

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IN THE

Supreme Court of the United States.

No. 81. October Term, 1944.

OTIS & CO.,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR PETITIONER.

OPINIONS BELOW.

The majority opinion of the Securities and Exchange Commission is printed in the Record. (R. 2-33.) Also the dissenting opinion of Commissioner Healy. (R. 37-77.)

The opinion of the District Court, for the District of Delaware (R. 82-95) is reported at 51 F. Supp. 217.

The opinion of the Circuit Court of Appeals, for the Third Circuit (R. 123-143) is reported at 142 F. 2d 411.

GROUNDS OF JURISDICTION.

The judgment of the Circuit Court of Appeals, for the Third Circuit (R. 142) affirming a judgment of the District Court, for the District of Delaware (R. 95-97) comes before this Court on a writ of certiorari granted June 12, 1944. (R. 144.) The jurisdiction of this Court was invoked under Section 240 (a) of the Judicial Code. (28 U. S. C. A. Sec. 347a.)

STATEMENT OF THE CASE.

1. The Parties.

The United Light and Power Company is a holding company registered under the Public Utility Holding Company Act of 1935. Aug. 26, 1935, c. 687, Title I, Sec. 33, 49 Stat. 838, 15 U. S. C. A. § 79, et seq. (R. 3.)

The Securities and Exchange Commission ordered The United Light and Power Company to liquidate and dissolve, and to comply with said order, the Plan under review was filed. It was approved by the Commission. (R. 78-82.)

Otis & Co., Petitioner, is a stockholder which deems itself aggrieved by the order of the District Court (affirmed by the Circuit Court of Appeals) approving the Plan and directing that it be carried out. It is the owner of only 10 shares of preferred stock, a fact to which counsel for The United Light and Power Company have forcefully adverted (brief of The United Light and Power Company in opposition to Petition for Writ of Certiorari, page 4, et seq.), but Otis & Co. was the underwriter for the entire issue of preferred stock ($60,000,000 par value) of which the rights and preferences are affected by the proceedings now being reviewed by this Court.

2. Summary of Matter Involved.

The judgment which petitioner seeks to review is one wherein the Circuit Court of Appeals, for the Third Circuit, affirmed a final Order entered by the District Court, for the District of Delaware, approving a Plan submitted by The United Light and Power Company under Sec. 11 (e) of the Public Utility Holding Company Act of 1935, 15 U. S. C. A. Sec. 79k (e), to comply with the requirements of Sec. 11 (b) of the Act, 15 U. S. C. A. Sec. 79k (b).*

* The Securities and Exchange Commission will be called "Commission." The United Light and Power Company will be called "Power" and the Public Utility Holding Company Act of 1935, 49 Stat. 838, 15 U. S. C. A. Sec. 79, will be called "the Act."

The Plan was prepared and filed with the Commission by the management of Power, which management was elected solely by the common stock of Power and therefore the Plan might well be termed a "common stock" Plan. The case originated in the District Court on an application of the Commission pursuant to Secs. 11 (e) and 18 (f) of the Act for Court approval and enforcement of the Plan submitted by Power. The Plan makes provision for the liquidation and dissolution of Power by first distributing all of its assets to its preferred and common stockholders on the basis of 94.52% and 5.48% respectively, although the total assets of Power do not have a present value equal to the liquidation preferences of the preferred stock as set forth in the charter. The District Court, nevertheless, found the Plan to be "fair, equitable and appropriate to effectuate the provisions of Section 11" of the Act and entered an Order directing that it be carried out. Petitioner contends that it is not "fair and equitable" to the preferred stockholders, of which petitioner is one, because it permits the common stock to participate in the assets of Power before the preferred is fully compensated.

3. Short Statement of the Matter Involved.

The facts are not in dispute. Power is the top holding company in a large public utility holding company system. (R. 3, 28A.) As it is a holding company with subsidiary companies, which are in turn holding companies, Sec. 11 (b) (2) (Second sentence) of the Act proscribes its continued existence in that it directs the Commission "to take such action" as is necessary to make such companies "cease" carrying on such enterprises. The Commission itself took action prior to the filing of the instant Plan to terminate the existence of Power. By Order dated March 20, 1941, the Commission directed that Power "shall be liquidated and dissolved." (Holding Company Act Release No. 2636; R. 105-121.) The Commission found that the present Plan (R. 77, 98-102) "is the final step in fulfill-

ing the portion of our Order of March 20, 1941, requiring the liquidation and dissolution of Power" (R. 5), and then held that the present Plan "provides for the liquidation and dissolution of Power." (R. 8.) The District Court stated: "I accept the findings of the Commission that there is necessity * * * for Power to liquidate pursuant to Sec. 11 (b) (2)." (R. 86.)

The charter of Power provides that "Upon the dissolution or liquidation of the corporation, *whether voluntary or involuntary*" the holders of preferred stock shall receive $100.00 per share, plus accumulated dividends, "before any payment is made to the holders" of the common stock. (R. 37.)

The Commission first found that the Plan was appropriate to effectuate the provisions of Section 11 of the Act, and then said:

> "The second required finding, namely, that the plan is 'fair and equitable to the persons affected by such plan,' presents a more difficult problem. The assets of Power are, in our opinion, of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942.
>
> * * * * * *
>
> "* * * present book values of assets pro forma are clearly insufficient to cover the liquidation preference of Power's preferred stock. Similarly, on the basis of a capitalization of reasonably anticipated earnings of the enterprise[9] we are unable to find an over-all value for the assets which approaches $98,700,000.
>
> * * * * * *
>
> (R. 9.)

"[9] It is clear that capitalization of prospective earnings, rather than book values, is the principal criterion of asset value. *Consolidated Rock Products v. DuBois*, 312 U. S. 510."

"* * * In the light of all the circumstances, we conclude that on no reasonable basis for capitalizing prospective earning power could we arrive at a valuation equal to the liquidation preference.

"If the amount of the liquidation preference of the preferred stock ($100 per share plus accumulated dividends) is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common."

(R. 11.)

The District Court said:

"* * * If the dividend claim is capitalized as a matured obligation, the total claim of preferred will be $98,700,000. All parties agree also that the assets * * * have not a present value equal to that amount. *If the contractual preferences are operative it is clear there will be nothing for the common shareholders.*

"The problem for determination is whether the plan is 'fair and equitable'. Concededly, the plan does not satisfy the 'absolute priority' rule which is applied in equity and bankruptcy reorganizations.[1] Under that rule, no plan can be fair and equitable which permits a junior security to retain an interest in the reorganized corporate enterprise before the securities senior to it have been paid in full (but not necessarily in cash) for the rights which they surrender. The value of the reorganized concern is projectively determined by a capitalization of the 'guess' earnings of the

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[1] Case v. Los Angeles Lumber Products Co., 308 U. S. 106; Consolidated Rock Products Co. v. duBois, 312 U. S. 510; Marine Harbor Properties v. Manufacturers T. Co., 317 U. S. 78; Ecker v. Western Pacific R. Corp., 318 U. S. 448, and Institutional Investors v. Chicago, M., St. P. & P. R. Co., 318 U. S. 523."

> new concern and comparing the valuation so arrived at with the total claims of the old senior securities. The present plan fails to meet this test, as junior interests are allowed to participate in the new capital structure of Railways when it is conceded that Railways' common is not worth $98,700,000 on any basis of valuation. *If the claims of the preferred stockholders are to be treated as matured as in an equity or bankruptcy reorganization, there can be no participation for the common stock under the 'absolute priorities' rule.*"
>
> (R. 86-87.)
>
> (Italics supplied.)

The Circuit Court accepted the findings of the Commission that "The assets of Power are * * * of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942." (R. 127.)

Although the Commission, the District Court and the Circuit Court all accepted the fact that the common stock of Power was "under water" upon every reasonable estimate of the present value of Power's assets, they nevertheless determined that it would be "fair and equitable" to give the common stockholders 5.48% of those assets upon the instant liquidation, upon the theory that the present claims of the common and preferred stock upon the assets of Power *should be determined as though in a continuing enterprise.*

The Commission said (Commissioner Healy dissenting):

> "* * * In our view, it is not inconsistent with the bankruptcy and equity precedents to conclude that in reorganizations or liquidations to comply with Section 11, stockholders affected should be given participations according to their contractual or other rights determined *as though in a continuing enterprise*, and that

the process of compliance with the statute should not be permitted to mature liquidation preferences."

(Italics in text.)

(R. 13.)

The District Court said in considering this view: "This is a new approach to the problem." (R. 88.) The Court followed this new approach, and concluded:

"* * * the common stockholders should be given a chance to recoup, especially where the reason for liquidation is purely fortuitous, and where the future condition of the new enterprise is based on a surmise."

(R. 89.)

The Circuit Court in affirming the District Court, said:

"* * * Though the preferred stockholders of Power have contract rights which entitle them to the payment of $100 a share and accumulated dividends on liquidation or dissolution of Power, those rights, at least in the absence of insolvency, have not matured and cannot mature for the reason that the congressional mandate contained in the Act strikes across contract rights and the maturities embraced by them, severing them." (R. 135.)

This new approach is one which has divided the Commission. The majority has now adopted it. Previously the Commission had said that a plan to effectuate the provisions of Section 11 (b) of the Act, which provided for stockholder participation where the corporation was insolvent, would not be fair and equitable, but instead would run "counter to the statutory standards of * * * Section 11." *In re Genesee Valley Gas Company, Inc.* (1938), 3 S. E. C. 104, at 115. Commissioner Healy has set forth his views, which are in opposition to the majority, in a

vigorous dissent in this case (R. 37-77) and in other dissenting and concurring opinions.*

After concluding that the claims of the preferred and common stock to the assets of Power should be determined as though in a continuing enterprise, the Commission indulged in a speculation as to what might happen in such event, ignoring the fact that the Act requires that the enterprise "cease." Sec. 11 (b) (2) (Second sentence). The Commission guessed that, if the enterprise continued, the arrearages on the preferred stock could be discharged at the expiration of 15 years, after which time there might be earnings available to pay dividends on the common stock, and because of this possibility the Commission determined that the Plan was "fair and equitable" in giving to the common stockholders 5.48% of the assets, having a value of approximately $4,000,000.00. (See Balance Sheet, R. 4.)

SPECIFICATION OF ERRORS.

Errors intended to be urged are those specified in the Petition for Writ of Certiorari entitled "Questions Presented" (p. 9), the Court of Appeals having ruled adversely to the contentions of Petitioner upon the questions there stated. Re-stated, the errors are:

1. The Court erred in holding that the instant Plan is "fair and equitable" within the meaning of that phrase as used in Section 11 (e) of the Act.

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*International Paper and Power Company, 2 S. E. C. 274, at 285 ff.; Federal Water Service Corporation, 8 S. E. C. 893; Columbia Gas and Electric Corporation, S. E. C. , Holding Company Act Release No. 3885 (1942); Engineers Public Service Company, S. E. C. , Holding Company Act Release No. 4114 (1943); Puget Sound Power & Light Company, S. E. C. , Holding Company Act Release No. 4255 (1943); Southern Colorado Power Company, S. E. C. , Holding Company Act Release No. 4501 (1943); Virginia Public Service Co., S. E. C. , Holding Company Act Release No. 4618 (1943).

2. The Court erred in holding that claims of the preferred stock to preferences upon this "involuntary" dissolution or liquidation are not to be considered as matured and a claim upon the assets of the corporation ahead of the claims of common stock.

3. The Court erred in holding that a Plan to liquidate, submitted by a corporation under Section 11 (e) of the Act to comply with the requirements of Section 11 (b) of the Act, which allows junior interests to participate and receive part of the assets before senior securities receive their full liquidation preferences, may, nevertheless, be approved by a District Court as "fair and equitable".

4. The Court erred in not holding that the "full or absolute priority" rule, as established in *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, is applicable to the instant Plan which was submitted under Section 11 (e) of the Act to comply with the requirements of Section 11 (b) of the Act.

ARGUMENT.

1. Status of Power Under the Act and the March 20, 1941, Order of the Commission.

Section 1 of the Act deals with the "Necessity For Control Of Holding Companies" and provides:

> "It is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted * * * to provide as soon as practicable for the elimination of public utility holding companies except as otherwise expressly provided in this title."

Section 11 of the Act places a duty on the Commission to "take such action as the Commission shall find necessary" to carry out the provisions of the Act. The Commission, pursuant to the duty placed upon it by the Act, on March 20, 1941, found "that the liquidation and dissolution of The United Light and Power Company and United American Company are steps necessary to comply with the requirements of the statute." (R. 119.)

An Order was accordingly issued on the same date, March 20, 1941, providing, inter alia:

> "The Commission having filed its findings and opinion herein, in which the Commission finds, among other things, that the action hereinafter directed to be taken is necessary and appropriate for the purpose of bringing about compliance with the second sentence of Section 11 (b) (2);
>
> "It Is Hereby Ordered, pursuant to Section 11 (b) (2) of the Public Utility Holding Company Act of 1935, particularly the second sentence thereof, that:
>
> "1. The United Light and Power Company shall be liquidated and dissolved."
>
> (R. 120.)

The Order of March 20, 1941, further directed that Power:

> "* * * shall proceed with due diligence to comply with the foregoing order, and shall make application to the Commission for the entry of any further orders necessary or appropriate for this purpose; and the respondent, The United Light and Power Company, may submit to the Commission herein for its approval a plan proposing a method of complying with Paragraph 1 of the foregoing order on a basis which is fair and equitable to its security holders, and providing for a determination of the relative rights and interests of its security holders in connection therewith; * * *"
>
> (R. 120-121.)

No appeal was taken from the Order of March 20, 1941, which *became the fixed point* from which to survey the rights of the security holders of Power. This is not open to question by Power or the Commission, as it has already been settled by a judicial decision sought by them. See: *New York Trust Co. v. S. E. C.*, 131 F. 2d 274 (C. C. A. 2), cert. den. 318 U. S. 786, Rehearing den. 319 U. S. 781. There it appears that one of the early steps taken by Power to comply with the March 20, 1941, Order was to file a Plan with the Commission providing for the retirement of its outstanding debentures, then not payable, by the payment of principal and accrued interest only. The Debenture Trustee objected, and urged that as a prepayment was being made, Power should be required to pay the same premium which would be payable upon a voluntary call by it. The Commission approved Power's Plan. The Debenture Trustee appealed and lost. The Circuit Court said:

> "Much of the elaborate argument of the petitioners (the Debenture Trustee) becomes irrelevant when once it is realized that the order of March 20, 1941 requiring the liquidation and dissolution of Power was not only clearly within the scope of the statute under

which the Commission acted and justified by the facts but having become final *has thereby become the fixed point from which to survey the right they now claim.*"

(Italics supplied.)

On the question of contract rights, the Court held:

"* * * we pass to the substantial question of whether the plan providing for the retirement of the bonds was unfair and inequitable to the debenture holders in failing to require the payment of any premium.

"*That depends upon the contract rights of the debenture holders under the applicable principles of contract law.*

* * * * * *

"* * * The order under review was, accordingly, fair and reasonable to all parties in interest since it provided for the payment of the bonds in a way *which discharged in full the contract obligations* of the dissolved corporation."

(Italics supplied.)

On the question of the continued existence of Power, the Court said:

"This continued existence was made impossible by the valid final order of the commission dated March 20, 1941.

* * * * * *

"This involuntary destruction of the corporation deprived it of any freedom of choice except perhaps as to the cost of its funeral."

This decision, favorable to the then contentions of the common stock management of Power, is a holding, in effect, that an involuntary liquidation of Power took place through the March 20, 1941, Order. In other words, the Commission, acting pursuant to the mandate contained

in the Act, directed, on March 20, 1941, that the enterprise Power was engaged in "cease" and that Power itself die.

We, therefore, find that the status of Power from and after March 20, 1941, and prior to the filing of the instant Plan, was that of a corporation whose existence had been terminated by an order of the Commission made under legislative requirement. There was nothing left for Power to do but comply with the valid, final order that it file a Plan proposing a method of liquidation. *Power had no further right to keep going.*

2. Charter Provisions Relating to the Common and Preferred Stocks of Power.

The Charter of Power provides:

> "The Common Stock of the Company shall be subject to the rights of the holders of the Class A Preferred Stock."
>
> (R. 38.)

and further:

> "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the Class A Preferred stock shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of such stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned), including the full dividend for the then current quarterly period, before any payment is made to the holders of any stock other than the Class A Preferred stock. Any assets thereafter remaining shall be distributable among holders of stock other than the Class A Preferred stock in accordance with their rights at the time of distribution."
>
> (R. 37-38.)

3. The Plan Ignores the Charter Rights of the Preferred Stock and Hence Is Not Fair and Equitable.

It is recognized and admitted by all parties hereto that the present value of Power's assets is less than the claim of the preferred stock upon a voluntary or involuntary liquidation. (R. 86.)

The instant Plan was filed pursuant to the provisions of Section 11 (e) of the Act, which require that in order for the Commission to approve it, the Commission must find it to be "fair and equitable to the persons affected." This Section provides further that if, as happened here, application is made by the Commission to a court for approval, the court also must find the Plan to be "fair and equitable." These findings were made by the Commission and the District Court, erroneously, we submit. In *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 60 S. Ct. 1, 84 L. ed. 110, this Court held the like requirement contained in Section 77-B of the Bankruptcy Act, that in order for a court to approve a Plan of Reorganization there must be a finding that it is "fair and equitable," necessitated the application of the "full or absolute priority" rule. This Court accordingly held that the Plan there under consideration was "not fair and equitable," inasmuch as it allowed stockholder participation when the assets were not equal to the par value and interest on the bonds.

In the instant case the only difference is that the senior securities, which are not being fully compensated, are shares of preferred stock, rather than bonds. There can be no difference in principle, however, because a contract between security holders of a corporation, whether expressed in a bond indenture or in a charter, must have the same standing when assets are distributed, whether by way of reorganization or by way of liquidation. Certainly if the preferred stockholders in the instant case had held bonds calling for a payment thereon equal to the par value and accrued interest upon a liquidation, before the common stock received anything, the con-

tract would be recognized and the Plan denounced as not being fair and equitable.

That the absolute priority rule applies as between classes of stockholders has been held in a number of federal court cases.* This principle was recognized in several cases cited by this Court in Note 14 in *Case v. Los Angeles Lumber Products Co.*, 308 U. S., at pp. 118-119, 84 L. ed., at p. 121.**

The principle was also recognized in *Standard Gas & Electric Co. v. Taylor, et al.*, 113 F. 2d 266, cert. den. 311 U. S. 699, where the court refused recognition to securities subordinate to the preferred stock upon a finding that there was not asset coverage sufficient to equal the par value and accumulated dividends of the preferred stock.

The fact that the instant Plan was prepared and filed in order to comply with the requirements of the Public Utility Holding Company Act, rather than to adjust a financial embarrassment, certainly does not change the meaning to be given to the words "fair and equitable." In the *Los Angeles Lumber Products Co. case* this Court said that the words are words of art, and had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations, prior to the passage of Section 77-B. We know that many equity receivership reorganizations were reorganizations of solvent corporations, and to apply the words "fair and equitable" to any such reorganization made it necessary to give charter preferences full and absolute recognition. In *Consolidated Rock Products Co., et al. v. duBois*, 312 U. S. 510, 61 S. Ct. 675, 85 L. ed.

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* *In re Utilities Power & Light Corporation*, 29 F. Supp. 763, appeal dismissed (C. C. A. 7, March 9, 1940); *In re Chicago Great Western Railroad Co.*, 29 F. Supp. 149 (N. D. Ill., 1940); *In re National Food Products Corporation*, 23 F. Supp. 979 (D. Md., 1939); *In re Porto Rican American Tobacco Co.*, 112 F. (2d) 635 (C. C. A. 2, 1940).

** *In re New York Railways*, 82 F. (2d) 739 (C. C. A. 2, 1936) cert. den. 298 U. S. 687; *In re Daniel Meyer, Murray & Young*, 93 F. (2d) 657 (C. C. A. 2, 1938).

982, this court recognized that, "the absolute priority rule * * * applied to reorganizations of solvent as well as insolvent companies." (312 U. S. 527.)

It seems clear that the requirement in Section 11 (e) of the Act that a Plan must be "fair and equitable" requires the application of the "full or absolute priority" rule, as used in the usual sense, namely, that the *present value* of the assets of the corporation must be ascertained and senior securities must be fully compensated before junior securities can participate. That was not done in this case. The Commission and the courts below have taken the position that the usual rule of "full or absolute priority" applicable to reorganizations under the Bankruptcy Act or in equity, is not applicable to any reorganization, liquidation or dissolution, or other proceedings taken to comply with the Public Utility Holding Company Act. The rule cannot be so limited. *What difference exists between a financial difficulty forcing a reorganization and some other difficulty which makes it impossible for the corporate venture to continue and thus calls for liquidation or reorganization?* In the course of corporate history we have seen public policy expressed by Congress and the people in many acts and amendments including the Sherman [1] and Clayton Acts,[2] the National Prohibition Amendment,[3] the Hepburn Act,[4] and now the instant Act to terminate public utility holding companies. All of these affected the destinies of corporations, and some terminated the enterprises in which they were engaged. The continued existence of any enterprise cannot be foreseen or guaranteed. There can be no difference between a liquidation forced by financial difficulty and one forced by some other difficulty. A public policy expressed in an Act of Congress is now terminating the enterprise in which Power was engaged, as it previously had of

[1] 26 Stat. 209, 15 U. S. C. A. Secs. 1-7.
[2] 38 Stat. 730, 15 U. S. C. A. Secs. 12-27.
[3] Const. 18th Amendment.
[4] 34 Stat. 584, 49 U. S. C. A. 1, etc.

corporations which had become trusts or were in the liquor business. The liquidation and dissolution ordered by the Commission now marks the finish line. Whatever the expectancies have been, the order of the Commission directed that the corporate existence of Power be terminated. The rules of payment to the respective security holders at the end, as laid down by the charter of Power, must govern.

4. In Valuing the Common Stock as Having Rights in a Continuing Enterprise the Commission Acted Contrary to the Intent of Congress, the Act, the Effect of the Order of March 20, 1941, and the Law.

The Commission and the courts below deviated from the normal application of the "absolute priority" rule by concluding that the Act did not mature the claims of the preferred stockholders to their liquidating preferences, on the theory that the matter should be treated "*as though in a continuing enterprise.*" (R. 13.) They do not treat this as the end. They ignore the effect of the March 20, 1941, Order. This approach is diametrically opposed to the intention of the Congress in passing the Act. *The very purpose of the Act was to end the domination of great public utility empires by holding companies through the ownership of common stocks having no real share in the assets.*

Prior to the passage of the Act, the preferred and common stockholders of Power had embarked upon a common enterprise to conduct a public utility holding company system with Power as the top company. Power had for its business the holding of stock in subsidiaries which were in turn public utility holding companies . The Congress determined that such enterprises had become "injurious to investors, consumers, and the general public." Sec. 1 (c). The Congress thereupon determined to provide for the "elimination" of such public-utility holding companies. Sec. 1 (c). Section 11 contains the "death sentence" of the Act. In the instant case the enterprise in which Power is engaged has received its "death sentence" under the ex-

press terms of the Act and under the order of the Commission of March 20, 1941. (R. 120-121.) The present Plan is intended to administer the death blow required by the law. *It is the end.*

The Commission, acting pursuant to the mandate contained in the Act, directed that the enterprise cease, but then, with complete inconsistency, valued the rights of the stockholders in and to the enterprise as though it were to continue. This new approach is diametrically opposed to the position taken in the *New York Trust Co.* case, *supra*, where, in effect, the common stock management of Power urged that the debentures had matured so that only principal and accrued interest need be paid, as would be the case at maturity. Through that device they were able to escape paying debenture holders what they would have been entitled to receive if their rights had been treated as if in a continuing enterprise. Now, however, this same management makes an about-face and would have the rights of the common stockholders treated as though in a continuing enterprise. Can the management of Power, controlled by its common stockholders, compel the bondholders to forego call premiums on the ground that the dissolution of Power is immediately necessary, and then, pursuant to the same Order, compel the preferred stockholders to forego their dissolution preferences on the ground that the enterprise is to continue?

In the *Los Angeles Lumber Products Co.* case, *supra*, this Court rejected a contention made by the stockholders almost identical with the instant contention made on behalf of the common stockholders. There, it was urged that as the bonds had not matured when the Plan of Reorganization was proposed, the stockholders were in a position "to remain in unmolested domination and control over the property" and hence had an equity entitling them to participation. This Court pointed out that when the Plan was proposed, the stockholders had waived their rights and that, "Certainly the surrender of a right thus waived is not adequate consideration for the dilution of the bondholders'

priorities which this plan would effect." *In the instant case there was and is no stockholders' right "to remain in unmolested domination and control over the property,"* because the Act itself, in Section 11 (b) (2) (Second sentence) has proscribed the continued existence of the enterprise pursuant to the "policy" of "elimination" of public utility holding companies set forth in Sec. 1 (c) of the Act. Furthermore, the Act provides that the Commission shall take steps to see that voting power is "fairly and equitably distributed among the holders of securities," which, in this case, would require that voting control be taken away from the valueless, inundated common stock and given to the preferred stock, and this would prevent the common stockholders from continuing in unmolested domination and control of the enterprise. In any event, the order of March 20, 1941, has, in effect, terminated the existence of Power so that the common stockholders do not in fact have a continuing right to conduct the enterprise, or to have their rights valued on a theory that they have "a right to keep going."*

What the majority opinion really does is to re-write the charter of Power. Where the charter now reads that:

> "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the preferred stock" shall be entitled to priority of payment,

(R. 37.)

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* Professor E. Merrick Dodd, in an article entitled, "The Relative Rights of Preferred and Common Shareholders in Recapitalization Plans under The Holding Company Act," 57 Harvard Law Review 295, 326, took the position that,

> "* * * what is involved is *the value of a right to keep going* which is not abrogated by Section 11 * * *." (Italics supplied.)

Professor Dodd fell into the error of assuming that there was "a right to keep going." It *was* abrogated by Section 1 (c).

the majority of the Commission would have it read that:

> "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, *except a dissolution or liquidation under the provisions of the Public Utility Holding Company Act, or any other legislative requirement which the organizers might not have foreseen*, the holders of preferred stock, &c."

This cannot be done. The fundamental principle underlying the rights of preferred stockholders is inherent in the word "preferred". Such rights are usually limited. The consideration for making them limited, however, is that they are "preferred". In the instant case, no matter how successful or profitable Power had been, the preferred was entitled only to receive a fixed dividend of six per cent, and a return of the par value of $100 per share. The common was entitled to all that remained. Per contra, the common agreed that the preferred would always have its dividend and entire principal before the common would receive anything. The present Plan does violence to both that principle and that agreement. Suppose the earnings and asset value of Power were and had always been such as to amply cover both the preferred dividend rights and the par value of the preferred. In that case, of course, the market value of the preferred would be well over par, because in these days any preferred stock having a secured six per cent return commands a substantial premium. Would the preferred stockholders then have been entitled to a greater participation than the charter provisions call for? Would they be entitled to the value of the preferred stock "as in a continuing enterprise"? On the theory advanced by the majority opinion of the Commission, the equities would require a recognition of the enhanced value of the preferred, yet that could not be given without rewriting the charter. In the instant case, the preferred stockholders are entitled to priority of payment. *Their claim is on all the assets ahead of the common.* The assets

are not enough to pay them, and it follows that the common should be eliminated. To paraphrase Commissioner Healy: By no "strange legal alchemy" should the common get part of the assets. (R. 38.)

5. The Distinction the Commission Seeks to Make Between an Equity or Bankruptcy Reorganization and a Reorganization Under Section 11 of the Act Is Illogical.

The Commission and the courts below refused to apply the "full or absolute priority" rule as established in *Case v. Los Angeles Lumber Co., supra,* upon the ground that "bankruptcy and equity precedents" should not be followed in dealing with "reorganizations or liquidations to comply with Section 11." (R. 13.) The Commission pointed out that in equity or bankruptcy reorganizations new securities are distributed among the old security holders "according to their contractual and other rights determined *as though in liquidation.*" (R. 12.) (Italics in text.) The Commission then determined, however, that "in reorganizations or liquidations to comply with Section 11, stockholders affected should be given participations according to their contractual or other rights determined *as though in a continuing enterprise.*" (R. 13.) (Italics in text.) This reasoning is not logical if we consider the intent of Congress in passing the corporate reorganization provisions of the Bankruptcy Act * and in passing the Public Utility Holding Company Act.

The reorganization provisions of the Bankruptcy Act, like equity reorganizations, seek to preserve going-concern value, and seek to give a means of continuing the enterprise with only an adjustment among the security holders of the securities they hold. *Liquidation is not involved.* In fact, Sec. 77B of the Act contemplated liquidation only in the event a reoragnization could not be effectuated. The

* Sec. 77-B, June 7, 1934, c. 424, 48 Stat. 912, 11 U. S. C. A. § 207; Chapter X, June 22, 1938, c. 575, 52 Stat. 883 et seq., 11 U. S. C. A. § 501, et seq.

Section provided that when reorganization was abandoned, if the corporation was solvent the proceedings should be dismissed, or, if insolvent, that *then* an Order should be entered directing "the estate to be liquidated." Sec. 77B, subdivision (c), clause 8. In Chapter X similar provisions were inserted. Chapter X, § 236, 11 U. S. C. A. § 636.

On the other hand, Congress determined to "eliminate" public utility holding companies, particularly such as Power, and certainly did not intend that Section 11 should become a means of continuing the enterprise or preserving a going concern. If the distinction is to be made, it would seem that it should be the other way and that in equity and bankruptcy reorganizations the securities should be valued "as though in a continuing enterprise" but not so in reorganizations to comply with Section 11.

6. Any Plan to Comply With the Act and the Order Would Have to be "Fair and Equitable", and Hence Could Not Provide for Common Stock Participation.

The Commission, through its counsel, has urged both in the courts below and in their memorandum on the Petition for Writ of Certiorari in this Court, that the Order directing liquidation and dissolution was merely the mechanical device selected in this case, and has taken the position that through other devices such as recapitalization or merger under State laws, Power could have achieved the same result, because, the contention is, in order for a preferred stockholder to prevail in a State Court in opposing a recapitalization or merger, the stockholder would have to prove that the Plan was so unfair as to amount to constructive fraud. This position, however, begs the question entirely, because it assumes that Power is still a free agent in the sense that it can recapitalize, merge, consolidate, or take other unregulated corporate action without having to comply with the standards of the Act. Power is a registered holding company with the Order of March 20,

1941, against it, and with the Act directing the Commission to see to it that the enterprise it is engaged in be terminated. The Order not only directed that it liquidate and dissolve, but provided that it should do that which it has done, namely, file a Plan of compliance under Section 11 (e).

Power has been powerless since the Act became law to take any steps (whether by way of merger, consolidation, recapitalization, or the instant step of liquidation and dissolution), which would not be subject to the standards of the Act as set forth in Section 11, that the same be "fair and equitable to the persons affected." Thus the argument that at some other time or place some other corporation in a similar financial situation to that of Power, but not under the Act and not subject to an Order of the Commission, might distribute an even larger percentage of its assets to common stockholders whose stock is under water, is without force, because Power is not in the position of an unregulated company.

Undoubtedly, if Power sought to merge, consolidate, or recapitalize under some State law, without regard to the Commission, the Act or the Order of March 20, 1941, the Commission would be the first one insisting that Power could not do it, and that Power could act only pursuant to a Plan of liquidation and dissolution which the Commission could affirmatively find to be "fair and equitable." In dealing with the very same Order now before this Court, the Commission did take that position in the *New York Trust Co.* case, *supra*, when the Debenture Trustee urged that Power's liquidation should follow some other course and be guided by state law. In the brief filed for the Commission in the United States Circuit Court of Appeals, for the Second Circuit, the Commission's position was stated, at page 12, as follows:

> "The Commission cannot (as petitioners contend) leave the course of liquidation to the means and controls provided by local statutes."

The brief goes on to point out that where a registered holding company is directed, as Power was, to comply with Section 11,

> "* * * the Commission must exercise jurisdiction to see that the program for compliance with the statute and the Commission's orders is *fair and equitable* and in accordance with the rights of the parties."
>
> (Italics supplied.)

Since the *New York Trust Co.* case has been decided on the ground that this final dissolution matured the outstanding liabilities, so that *bondholders'* rights could not be treated "as in a continuing enterprise," it cannot now be "fair and equitable" to treat *other security holders* "as in a continuing enterprise."

Another instance of the Commission's opposition to compliance by way of dissolution under State law is the opinion of the Commission, "*In re The North American Company and Its Subsidiary Companies*," 9 S. E. C. 617. It shows that North American Light & Power Company, a registered subsidiary holding company of The North American Company, a registered holding company, called a meeting of stockholders for the purpose of having them vote to dissolve under state law. This was done while Section 11 proceedings involving the two companies were pending before the Commission. No Order directing a compliance with Section 11 had been entered, as here, and North American Light & Power Company took the position that the contemplated dissolution under state law would be a compliance with the Act. The Commission entered an Order prohibiting such action and said in its Opinion, inter alia:

> "In a Section 11 (b) (1) case, the statutory obligation and duty imposed upon this Commission is the determination of what action the Commission shall find

necessary to bring about compliance with Section 11 (b) (1)."

(9 S. E. C. 620)

* * *

"In effect, the company is taking upon itself, without supervision or authority of this Commission, the discharge of functions that Congress committed to this Commission.

* * *

"* * * it seems to us that The North American Company and its subsidiary, the Light & Power company, are acting in a manner that frustrates or aborts the statutory duty of this Commission."

(9 S. E. C. 621)

Not only did the Commission enter its own Order but, to stop the proposed voluntary dissolution, also filed a Complaint in the United States District Court, for Delaware,* alleging the facts in the Opinion referred to above, and, in paragraph 21 thereof, said: "The proposed dissolution of Light & Power is in circumvention of the Act." The prayers were to enjoin the holding of the contemplated meeting and to enjoin the company "from dissolving or liquidating."

The argument that the same or a better result could be achieved for the common stockholders under state law should receive the same reply the Circuit Court of Appeals, for the Ninth Circuit, made to a similar contention in the case of *duBois v. Consolidated Rock Products Co., et al.*, 114 F. 2d 102, at 108:

"it is further said that the plan must be held to be fair because it achieves, by one step, results which

* "*Securities and Exchange Commission, Plaintiff, v. The North American Company and North American Light & Power Company, Defendants. Civil Action No. 214.*" Filed June 4, 1941.

could be achieved under California law by several steps. Such fact, if it be a fact, is immaterial. This proceeding is pending under the federal law and must meet the requirements of that law."

The test which the Commission and the District Court must apply before approving a Plan filed under Section 11 (e) of the Act is not whether a proposed Plan is so unfair as to amount to fraud, but whether there can be an affirmative finding that the Plan is "fair and equitable." It makes no difference in the application of that standard what device be used, whether liquidation and dissolution, recapitalization, or merger.

When the Plan, whatever the device used, contemplates the surrender of outstanding securities for new securities, either in the same or a different company, it is not "fair and equitable" to force senior security holders to accept less than that which they are contractually entitled to receive. Any Plan by which common stock of Power is allowed to receive approximately $4,000,000.00, while the preferred stock receives less than its claim against the assets, i. e., par plus accrued dividends, would not be "fair and equitable" to the preferred stockholders. The means used is unimportant. The important thing is that under the present Plan $4,000,000.00 is being taken from the preferred stockholders and given to the common stockholders. No scheme should be allowed which will do that.

7. The Action of the Commission and the Courts Below Was Contrary to the Rule Laid Down by This Court in the Reading Case.

The District Court referred to the treatment accorded the Plan by the Commission as a new approach. It is only new in the sense that prior to this action by the Commission such an approach was considered unfair and subject to judicial condemnation. This Court prevented common

stockholders from enjoying the fruits of having their rights valued as in a continuing enterprise upon a dissolution forced by judicial decree in the case of *Continental Ins. Co. v. United States*, 259 U. S. 156, at 177-181, 66 L. ed. 871 at 886-888, and said:

> "*The rights of the common and preferred stockholders of the Reading Company inter sese are to be determined by the organization agreement of 1896.*"
>
> (Italics supplied.)

The decision in the *Continental Ins. Co.* case, known as the *Reading* case, must be ignored or overruled if the instant Plan is to be carried out. The only difference between that case and the instant one is that the former arose under the anti-trust laws and the liquidation and dissolution of the company was forced by virtue of the anti-trust laws, rather than, as here, by virtue of the Public Utility Holding Company Act. There, the common stockholders contended that in dividing the assets between the preferred and common stock, pursuant to a forced liquidation and dissolution, the common stock should be treated *as though in a continuing enterprise and not as though upon liquidation.* In that case the Reading Company and certain other companies were found to have formed an illegal combination and a decree was entered "requiring dissolution." This Court, in an earlier opinion had remanded the case to the District Court and directed a decree "dissolving the whole combination * * * and such disposition of the stocks and bonds and other property of the Reading Company as might be necessary." This was similar to the steps in the instant situation, in that the order of March 20, 1941, had directed the dissolution of Power and the disposition of its assets. The Reading Company proposed a Plan under which the assets of one of its subsidiaries were to be transferred to a new corporation and rights to subscribe to the stock of the new corporation were to be offered share-for-share alike to the preferred and common stockholders of

the Reading Company. These rights were very valuable and constituted a distribution of the surplus of the Company. The common stockholders objected on the ground that, but for the dissolution, the enterprise could continue and the surplus would be available for distribution on the common stock, and, therefore, a division of the surplus between the preferred and the common in accordance with the liquidation provisions of the charter was not fair. This Court ruled that a liquidation was taking place and the charter provisions governing liquidation had to prevail and that the rights of the common stockholders could not be treated as though in a continuing enterprise. The charter provided that the preferred and common should share equally in a distribution of assets upon a liquidation, and in directing that these charter provisions must govern, this Court in effect matured the liquidation rights of both classes of stock upon the "compulsory winding up and liquidation of the corporation." (259 U. S. 180.)

In the instant case the Public Utility Holding Company Act interdicted the enterprise, while in the *Reading* case the anti-trust laws interdicted the enterprise. In the instant case the order of March 20, 1941, directed the liquidation and dissolution as did the order of the Court in the *Reading* case. In both cases the Acts, plus the orders directing liquidation and dissolution, matured the claims of all classes of stock to the assets, and the rights of both common and preferred stockholders were, in the *Reading* case, and should be, in the instant case, determined by the charter.

* * * * * *

It would serve no useful purpose to duplicate the very able presentation of both the law and the facts made by Commissioner Healy in his dissenting opinion herein (R. 37-77) and in his dissenting opinion in the case of *Federal Water Service Corporation*, reported in 8 S. E. C. 893 at page 921, and in others. See footnote, page 8, supra. This Court is respectfully referred to those opinions for his complete analytical study of the principles involved herein.

CONCLUSION.

It is respectfully urged that the Plan under consideration is not fair and equitable to the preferred stockholders herein and that the approval thereof by the District Court should be reversed.

Respectfully submitted,

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APPENDIX.

The pertinent provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803 (15 U. S. C. §§ 79, *et seq.*), are as follows:

SECTION 1 (c):

> (c) When abuses of the character above enumerated become persistent and wide-spread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

SECTION 11 (a):

> (a) It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which

the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

SECTION 11 (b) (2):

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

* * *

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any

company whose principal business is that of a public-utility company.

* * *

SECTION 11 (d):

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

SECTION 11 (e):

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection

of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 983

OTIS & CO., *Petitioner*,

v.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY, *Respondents*.

In the Matter of the Application of Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 With Respect to The United Light and Power Company.

BRIEF FOR RESPONDENT, THE UNITED LIGHT AND POWER COMPANY, IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

DONALD R. RICHBERG,
JOHN DERN,
Attorneys for Respondent,
The United Light and Power Company.

CLARENCE A. SOUTHERLAND,
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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

Supreme Court of the United States

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No. .....

OTIS & CO., *Petitioner*,

v.

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In the Matter of the Application of Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 With Respect to The United Light and Power Company.

BRIEF FOR RESPONDENT, THE UNITED LIGHT AND POWER COMPANY, IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinion of the United States District Court for the District of Delaware, approving the plan submitted by The United Light and Power Company, which had been ap-

proved by the Securities and Exchange Commission (R. 123), is reported in 51 F. Supp. 217; and appears in the Record at page 94a.

The opinion of the United States Circuit Court of Appeals for the Third Circuit affirming the judgment of the District Court was filed April 20, 1944 and appears in the Record at page 144.

ADDITIONAL STATEMENT OF THE CASE.

The petitioner neglects to state its interest in the subject matter or to explain the manner in which it became a party to this proceeding. These facts are pertinent to an exercise of the discretion of this Court in granting a writ of certiorari.

Throughout the proceedings before the Securities and Exchange Commission (hereinafter referred to as the "Commission"), which led to the approval of the plan submitted by The United Light and Power Company (hereinafter referred to as "Power") for its dissolution in order to comply with the requirements of the Public Utility Holding Company Act of 1935 and the orders of the Commission issued under the authority of said Act, there was no appearance by Otis & Co. nor objection raised by said company, or by any other preferred stockholder, to the proposed plan.

The Commission, before entering its final order, required that the distributive share of the preferred stockholders should be increased from 91.2 per cent of the common stock of The United Light and Railways Company (hereinafter referred to as "Railways") to an allocation of 94.52 per cent of Railways' common stock to Power's preferred stockholders. Thereby, the allocation originally proposed of 8.8 per cent of Railways' common stock to the common stockholders of Power was reduced to 5.48 per cent. There was ample notice and opportunity for any preferred stockholder or common stockholder to have objected to the plan before the Commission. The record shows that repeated

notices were given to all stockholders of Power concerning the proceedings before the Commission (R. 4a, 93a). But the record shows that no objection was raised by any stockholder of Power either to the proposed or to the allowed allocation.

No appeal was taken by Otis & Co., or by any other party, from the order of the Commission to the Circuit Court of Appeals within sixty days as provided by the statute in Sec. 24 (49 Stat. 834, 15 U. S. C. ¶79x).

When the Commission applied to the United States District Court for the District of Delaware for an order approving and providing for the enforcement of the plan approved, notice was given, as directed by the court, to all stockholders of Power; and the order of the court required that any objections to the proposed enforcement of the plan approved by the Commission should be served on or before June 1, 1943 on counsel for the Commission and counsel for the company, and filed with the clerk of the District Court. Otis & Co., although fully advised of the original hearings before the Commission and of the hearing and of the requirements imposed by the order of the District Court, neglected to take any action whatsoever prior to their service of a notice of objections dated June 10, 1943, to which notice was attached a proposed answer (R. 96a). The District Court, upon the hearing of the case on June 15, 1943, permitted Otis & Co. to be heard and, following the order of the District Court approving the plan, Otis & Co. perfected an appeal to the United States Circuit Court of Appeals for the Third Circuit.

Otis & Co. is the owner of 10 shares of preferred stock out of a total of 600,000 shares outstanding (R. 95a, 96a).[1]

[1] The opinion of the Circuit Court of Appeals inadvertently refers to Otis & Co. as the holder of "fifty" shares of preferred stock. The answer and affidavit filed by Otis & Co. in the District Court claimed ownership of only *ten* shares. This amount is referred to twice in the District Court opinion.

QUESTIONS INVOLVED.

The petitioner seeks to have the Court review the action of the Securities and Exchange Commission in approving the plan for the dissolution of Power which was presented by Power under the compulsion of the statute and the orders of the Commission. The petitioner seeks to have the judgments of the District Court and of the United States Circuit Court of Appeals approving the action and order of the Commission reversed on the ground that the Commission and the two courts were in error in holding the plan of dissolution to be fair and equitable to the preferred and common stockholders of Power. The petitioner gives as a reason for the allowance of the writ that "the principles involved in the case at bar are of great public importance."

In behalf of the respondent, Power, it is submitted that the question presented *at the outset* is this: Is it a matter of sufficient public importance for this Court to determine whether a plan for the dissolution of a holding company is "fair and equitable" to the holder of 10 shares of preferred stock when that plan (after approval *sub silentio* by the holders of 599,990 shares of preferred stock and 3,476,768 shares of common stock) has been approved by the Commission, the District Court, and the Circuit Court of Appeals?

ARGUMENT.

I.

Petitioner's Interest is Insufficient to Warrant the Grant of the Writ.

In view of the trifling monetary interest which the petitioner, Otis & Co., as owners of 10 shares of preferred stock, has in the outcome of this case, the petitioner, in the lower court, claimed to have a special interest because Otis & Co. had once acted as an underwriter for the preferred stock. Obviously, Otis & Co. would have no standing to intervene below or to appeal to this Court on the basis of

any such metaphysical interest. It has been frequently held that a right of action or a right to appeal must be founded on a real and substantial interest, and that litigations cannot be carried on merely in order to establish a precedent or to clarify the law, even as to such important matters as constitutional right.

> "Broadly speaking, the right of a party to an appeal or a writ of error must be based upon a direct, immediate, pecuniary, and substantial interest in the particular litigation in which review is sought." 4 C. J. S. 349, Par. 177 (citing *Hamilton Trust Co.* v. *Cornucopia Mines Co. of Oregon*, 223 F. 494; Certiorari denied 239 U. S. 641).

See also:

Massachusetts v. *Mellon*, 262 U. S. 447, 487, 488.

> "The party who invokes the power must be able to show not only that the statute is invalid but that he has sustained or is immediately in danger of sustaining some direct injury as the result of its enforcement, and not merely that he suffers in some indefinite way in common with people generally."

Boston Tow Boat Co. v. *United States*, 88 L. ed. Adv. Op. U. S. Sup. Ct. 720 (decided April 3, 1944) . . . where it was held that an intervenor without pecuniary interest could not prosecute an independent appeal, simply to obtain a precedent for use in similar litigation.

So the petition of Otis & Co. must rest upon its interest in the 5.48 per cent enhancement of the value of 10 shares of preferred stock. This stock, according to its own contentions, is worth less than $100 per share, so that the maximum gain which it could legitimately obtain from this extensive litigation would be $54.80. Otis & Co. has carried this $54.80 litigation through two courts and has obviously had its "day in court." It cannot be seriously aggrieved if the United States Supreme Court decides that, in the language of Mr. Justice Holmes, "somewhere there must be an end." We submit that it is not a matter of "great

public importance" to have the claim of Otis & Co. reviewed by this Court.

When it is argued that the questions presented are of great public importance, we suggest that *it is of even greater public importance not to encourage litigations of this character*, not to encourage persons with insubstantial interests to raise questions of alleged "great public importance," merely for the purpose of obtaining judicial decisions which they themselves have no more reason to seek than any one of several million people who may be interested in questions of public importance. We submit that the time of the courts, and particularly of the highest Court, should not be absorbed in passing upon theoretical questions for the amusement or ulterior profit of litigious persons, who have no substantial, pecuniary interest in having such questions determined.

II.

The Dissolution of Power Should Not Be Further Delayed.

In exercising its discretion in the grant or denial of the writ of certiorari, we submit that it is appropriate for the Court to consider the injury to public and private interests which has already been done and will be increased by further delay in enforcing the Commission's Order of April 5, 1943.

In accordance with the statutory request of Power, the Commission applied promptly to the United States District Court for the District of Delaware to enforce its order, and the plan for dissolution would have become operative, after its approval by the District Court August 4, 1943, if the case had not been further litigated by Otis & Co. in behalf of 10 shares of preferred stock. The dissolution of Power would have been carried through long ago and the common stock of Railways, now owned entirely by Power, would have been distributed, 94.52 per cent to the preferred stockholders of Power and 5.48 per cent to the common stockholders of Power, thereby transferring the control of Rail-

ways from Power, that is, from the common stockholders of Power, with voting rights solely in Class B, to the present preferred stockholders of Power. The litigation carried on by Otis & Co. has simply kept the real owners of Railways (the preferred stockholders of Power) out of actual possession and control of their property. It has also caused the maintenance of the needless expense of maintaining Power as a corporate entity. It has imposed the burden of this litigation upon the investors in Power.

This litigation has also impeded the administration of the Public Utility Holding Company Act, both in its application to this large utility system and in the restraint necessarily imposed upon the Commission in other matters. So long as a question of authority or exercise of discretion is being litigated, no matter how fruitlessly, it follows that the Commission will be embarrassed in its functioning in similar matters. Again, we submit that there is no public interest to be served in encouraging litigation for the sake of litigation by those who have no substantial interest which is visibly to be served.

III.

The Questions Presented Are Not of Great Public Importance.

It may be true that, in the language of the Circuit Court of Appeals, "The *principles* involved in the case at bar are of great public importance." But that does not mean that the *issues* which petitioner seeks to present to this Court are of great public importance, except so far as it is always a matter of public importance to have well-grounded precedents maintained. This Court has held frequently that the exercise of administrative discretion by administrative commissions should be respected. (See *U. S. v. Morgan*, 313 U. S. 409, 422.) It would be a matter of great public importance if *that* doctrine should be disputed and it appeared possible that the Court might reverse its previous rulings. But a mere demand that the

Court set aside an order of the Commission which has been made in the exercise of its administrative discretion does not actually present *that* fundamental issue which would be of "great public importance."

The petitioner endeavors to argue that the rule of "absolute priority" has been disregarded by the Commission. This is inaccurate and misleading, because the Commission, in its opinion, expressly stated that "absolute priorities must be respected." Then the Commission held that the accumulation of preferred dividend arrearages does not constitute a matured claim in the absence of liquidation, and further held:

> "To accelerate the arrearages and translate them into matured claims at their full face amount, so as to entitle the preferred stock not only to all the assets but also in perpetuity to the entire earning power of those assets—a portion of which would otherwise have been applicable to the common stock—would clearly be to enrich the preferred at the expense of the common." (R. 19a)

Accordingly, the Commission in making an administrative application of the law committed to its administration, determined to carry out the intent of the Congress and to distribute the assets of the dissolved company in such a way as not to deny to the common stockholders, who had put a substantial cash investment into the enterprise,[1] any participation at all in the *continuing enterprise*. The *enterprise* was *not* being *liquidated*. The holding company was being dissolved because of the statutory mandate. Other methods of reorganization or consolidation might have left *this* company intact. It seemed clearly unfair and inequitable to the Commission that the statutory mandate should be so applied, in dissolving one company in the system, as to enrich unjustly one group of the stockholders of that company at the expense of another.

[1] "Common's contribution to capital amounts to $28,482,745 preferred's $60,000,000."—Opinion of District Court (R. 103a).

Throughout its petition and brief, petitioner seeks to have it appear that "an Act of Congress is now terminating the existence of Power." (Pet. Brief, p. 20), and that "Power has received its death sentence under the express terms of the Act" (p. 22), and that "as the venture cannot continue, preferred stockholders are entitled to their contractual rights" (p. 22) . . . meaning thereby their rights upon a complete liquidation of the enterprise.

Such statements and arguments distort both the law and the facts. The Public Utility Holding Company Act of 1935 did not end utility enterprises or terminate the existence of any particular company. The law merely required the simplification of holding company systems; and that would necessitate the elimination of *some* companies and the continuance of others, Sec. 11(b) (49 Stat. 820, 15 U. S. C. 79k).

There were several alternative methods of simplifying this system. The Commission selected that method which called first for the dissolution of the top company, instead of another company.[1] But that choice should not operate to despoil common stockholders of rights and values which they would have retained if another company had been dissolved and Power had continued its corporate existence (R. 15a, 32a). The Commission's present exercise of discretion is based upon its previous exercise of discretion in ordering the dissolution of Power. That major action was never challenged or reviewed, by any court. Why should a minor subsidiary action be now reviewed?

It should be apparent that the Commission was acting in that realm of administrative discretion in which Congress had invested the Commission with its powers for the very purpose of making sure that the intent and spirit of the law should be made effective. The Commission reached a conclusion which was described in its own opinion as "of necessity one of over-all judgment and not susceptible of

[1] Order of Mar. 20, 1941, Holding Company Act Release No. 2636. (R. 4a)

mathematical demonstration." (R. 31a) Now petitioner seeks to have the Supreme Court lay down a rigid ruling which would fetter the exercise of the Commission's discretion and eliminate that flexibility of judgment which it is clearly the intent of the law that the Commission should exercise. If it were necessary to assure the Commission that reasonable exercises of its judgment will be sustained in the courts, the question raised might be one of great public importance. But since the Commission's authority and discretion has been heretofore and frequently sustained, we submit that a question of great public importance is not raised by a petition for review in a case where the Commission has simply exercised its statutory power and discretion to determine what is "fair and equitable."

> "Determination of what is 'fair and equitable' calls for the application of ethical standards to particular sets of facts, but these standards are not static. In evolving standards of fairness and equity, the Commission is not bound by settled judicial precedents." *Securities and Exchange Commission* v. *Chenery Corporation*, 318 U. S. 80, 89.

CONCLUSION.

In the brief in behalf of the Commission, there will be presented ample authority and argument to sustain the action of the Commission. It seems unnecessary, and an imposition on the Court, to present at this time a similar argument. We do not believe the Court is required to undertake even a hasty review of the merits of the Commission action.

There may be a natural hesistance on the part of the Commission, when its orders are attacked, to oppose any appeal for judicial review, especially where one member of the Commission has filed a dissent. But, in behalf of the respondent company, and in the interest of its stockholders as a whole, we submit that it is neither necessary nor desirable, in aid of public or private interests, to have a fur-

ther delay in the determination of this proceeding to gratify the litigious desires of the owners of 10 shares of stock.

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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The United Light and Power Company.

CLARENCE A. SOUTHERLAND,
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May 24, 1944.

No. 81.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

OTIS & CO., *Petitioner*,

v.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY, *Respondents*.

BRIEF FOR RESPONDENT, THE UNITED LIGHT AND POWER COMPANY.

(On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.)

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SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY, *Respondents*.

BRIEF FOR RESPONDENT, THE UNITED LIGHT AND POWER COMPANY.

(On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.)

OPINIONS BELOW.

The opinion of the United States District Court for the District of Delaware, approving the plan submitted by the United Light and Power Company, which had been approved by the Securities and Exchange Commission (R. 2), is reported in 51 F. Supp. 217; and appears in the Record at page 82.

The opinion of the United States Circuit Court of Appeals for the Third Circuit (R. 123) affirming the judgment of the District Court is reported in 142 F. (2d) 411 (under the title of "*In re Securities and Exchange Commission*"). (R. 123)

ADDITIONAL STATEMENT OF THE CASE.

The facts are not in dispute but petitioner's statement is inadequate for a proper understanding of the issues. The following facts are pertinent:

By an application filed on July 24, 1940, and amended October 19, 1940, The United Light and Power Company (hereinafter called "Power") submitted to the Commission for its approval a Plan of Recapitalization and Simplification under Section 11(e) of the Public Utility Holding Company Act of 1935 (hereinafter called the "Act"), which provided for a reduction in the capital of Power, the creation of an adequate reserve for depreciation of investments and the reclassification of the preferred and common stocks of that company into a single class of new common stock. The plan was proposed in order to simplify the capital structure of Power, to distribute voting power fairly and equitably among all of its stockholders and to place the company in a position to pay dividends to the extent earnings might permit, no dividends having been paid since 1932. In this plan, the management of Power, after careful and impartial consideration of the interests of all stockholders, proposed a division of the new common stock on a basis substantially as follows: 91.20 per cent to the preferred stockholders, 6.13 per cent to the Class A common stockholders, and 2.67 per cent to the Class B common stockholders. (R. 106)

On December 6, 1940, before a hearing was held on the Plan of Recapitalization and Simplification, the Commission instituted proceedings to determine what action Power and its subsidiaries, including The United Light and Railways Company (hereinafter called "Railways") must take

to comply with Section 11(b)(2) of the Act. These proceedings were consolidated with the proceedings relating to the Plan of Recapitalization and Simplification above referred to, and the proceedings were also subsequently consolidated with proceedings which had been instituted by the Commission on March 8, 1940, under Section 11(b)(1) of the Act.

Since the holding company system did not meet the standards prescribed by the second sentence of Section 11(b)(2), the Commission decided that before passing on the Plan of Recapitalization and Simplification it should first determine what action should be taken to bring the holding company system into compliance with that sentence of the Act and, after considering alternative methods of compliance, an order was entered on March 20, 1941, requiring the liquidation and dissolution of Power. (R. 105-120) Thus, the Plan of Recapitalization and Simplification was abandoned and action was initiated to comply with the dissolution order which required Power to proceed with due diligence to carry out its terms. No appeal was taken by anyone from the Commission's order of March 20, 1941, and that order is not now subject to judicial review.

Power and Railways, together with other companies in the holding company system, then completed a series of transactions the consummation of which was necessary to place Power in a position to liquidate and dissolve. As a result, Power paid or became discharged of further liability on its bonds and debentures and placed itself in a position to complete its liquidation by distributing among its stockholders the common stock of Railways, all of which is owned by Power, and by contributing to Railways all other assets of Power. To accomplish this final step, the plan now involved in litigation was submitted to the Commission on July 1, 1942. It originally provided that 91.2 per cent of the common stock of Railways should be distributed to Power's preferred stockholders and that 8.8 per cent thereof should be distributed to its common stockholders,

being the same allocation as that previously proposed in the Plan of Recapitalization and Simplification filed in 1940.

The Commission, in its findings and opinion entered April 1, 1943, concluded that it would not approve the plan unless it was amended to reduce the participation of the common stockholders to approximately 5 per cent, and Power and Railways amended the plan to conform to the Commission's views. The plan as amended provides that the par value of the outstanding common stock of Railways shall be reduced; that the number of shares of such stock shall be increased; that 94.52 per cent of the new common stock of Railways shall be distributed to the preferred stockholders of Power, and 5.48 per cent thereof to the common stockholders; and that all other assets of Power shall be contributed to Railways.

On April 5, 1943, the Commission entered its supplemental findings and opinion and an order approving the plan as amended. On April 16, 1943, the Commission applied to the District Court of the United States for the District of Delaware for an order approving and enforcing the plan, and on August 4, 1943, that Court approved the plan.

On August 25, 1943, Otis & Co., as the holder of ten shares of preferred stock of Power, filed an appeal from the order of the District Court with the United States Circuit Court of Appeals for the Third Circuit, contending that the plan was not fair and equitable to the preferred stockholders of Power because it permitted the common stockholders to participate in the distribution. The Circuit Court of Appeals affirmed the action of the District Court in an opinion rendered on April 20, 1944. No other preferred stockholder and no common stockholder appealed from the order of the Commission or the order of the District Court.

On May 11, 1944, Otis & Co. filed a petition for a writ of certiorari with this Court, which granted the petition on June 12, 1944.

We call attention to these significant facts: (1) That the distribution of Railways' common stock originally proposed in the plan now being reviewed was the same as that which had been proposed in the recapitalization plan submitted by Power in 1940; (2) that before submitting its plan of 1940, the management of Power had carefully canvassed the situation and weighed the respective rights of the different classes of stockholders of Power in order to propose a division of interests which would appeal to the different classes of stockholders as fair and equitable; (3) that the possibility of such a division of interest has been made evident to the stockholders of Power ever since 1940 and, from the absence of any significant opposition thereto, might properly be regarded as generally satisfactory to these stockholders; (4) that the absence of any opposition among the stockholders (both preferred and common) to the proposed division of interests throughout the consideration thereof by the Commission gives strong evidence of widespread acceptance by the stockholders of such a division as thoroughly fair and equitable; (5) that the present insignificant opposition of one small stockholder (Otis & Co. is the owner of only *ten* shares of preferred stock, R. 96) to the order of the District Court gives convincing evidence that the preferred stockholders, as a class, are satisfied with the percentage of interest in the common stock of Railways which has been allotted to them.

Counsel for petitioner are inexcusably inaccurate in referring to the plan under review as a "common stock plan" (Brief, page 3) and in describing the management of Power as a "common stock management". (Brief, page 12) Although the management was elected by common stockholders, it proposed from the beginning a reorganization in which the preferred stockholders would receive over 90 per cent of the new voting stock. The management sought impartially to fulfill its duty to all stockholders of Power and certainly showed no partiality for the common stockholders in proposing to reduce their present interest in owning and voting to a very small percentage.

The Interest of Otis & Co., Petitioner.

Throughout the proceedings before the Commission, Otis & Co., the present petitioner, was the owner of its entire present stock holding, that is, *ten shares* of preferred stock. But the record shows no opposition by Otis & Co. to the liquidation of Power as proposed or as approved by the Commission. There was no appeal taken from the order of the Commission of March 20, 1941 requiring the liquidation of Power. There was no appeal by Otis & Co. or by any other person from the order of the Commission approving the plan for liquidation. The Commission, responding to the request made by Power in submitting its plan, made application to the District Court of the United States for the District of Delaware to enforce and carry out the terms of the modified plan which had been approved by the Commission. The District Court required notice to be given to all stockholders of Power and required that any objections to the consummation of the plan approved by the Commission should be filed and served on or before June 1, 1943.

Otis & Co. offered their first opposition to the plan on June 10, 1943, ten days after they were in default, but five days prior to the hearing held June 15th, in which the District Court permitted Otis & Co. to be heard. After the District Court entered its order approving the plan on August 4, 1943, Otis & Co. appealed to the United States Circuit Court of Appeals for the Third Circuit.

Counsel for Power do not call attention to these facts as the basis for again arguing that the writ of certiorari should be denied because petitioner's interest is so trifling and insubstantial. But these facts do provide the basis for urging that substantial evidence that the plan approved by the Commission is fair and equitable may be found in the fact that objection has been raised only by the owner of 10 shares of preferred stock out of a total of 600,000 shares outstanding and that no objection has been made by the owners of 3,476,760 shares of common stock.

Furthermore, the petitioner, the present objector, with full knowledge that the management proposed a similar but slightly smaller distribution to preferred stockholders in 1940, and again in 1942, recorded no opposition throughout the lengthy proceedings before the Commission (although having ample notice thereof). Only after being ten days in default in the District Court Otis & Co. sought at the eleventh hour to upset, or at least to delay, consummation of the efforts of the Commission and the company management to comply with the law in a manner fair to all concerned. The unfair character of such opposition discredits petitioner's judgment as to what is "fair and equitable."

The Facts Relating to Liquidation.

Since the entire argument of petitioner is based on the technical proposition that Power is being "liquidated" and that the charter rights of preferred stockholders in a liquidation have been disregarded, it is pertinent to review the proceedings which led to the order of March 20, 1941. Such a review will demonstrate that the *enterprise* in which the stockholders of Power invested their money is not being liquidated and that their investment in that enterprise is not being discontinued. In substance and in fact, the security structure of the enterprise is merely being readjusted to meet new congressional standards; and the investment of all stockholders in the enterprise is being continued. A review of the proceedings will demonstrate that the dissolution of Power was not inevitable, in order to comply with the law, but was ordered as the most practical of several available methods of accomplishing the same result. Dissolution of the top company was ordered only because it was the most feasible method of complying with the law without doing violence to the rights and interests of thousands of investors in this holding company system.

The record shows that the Commission considered three alternative methods of compliance with the law and finally decided that the elimination of Power was the most prac-

tical and expeditious method. This dissolution was not required by any insolvency or financial stress of Power and was not motivated by any desire or intention to discontinue the business. It was only required because, to comply with the Act, it was necessary to simplify the structure of the United System and necessary to eliminate one or more of the holding companies in that System. The many proceedings in the past and now pending before the Securities and Exchange Commission affecting the United System are all parts of a program of reorganization largely necessitated by the requirements of the Act. It will be appropriate, therefore, in the following argument, to call attention to the facts of record showing that what is here under consideration is a "liquidation" in name only and is in substance and in fact a reorganization.

We contend that a charter provision intended to determine the rights of stockholders upon the happening of a specified contingency should not be invoked to determine their rights upon the happening of other contingencies of a different nature, and particularly where the contingency which occurs was not of a type anticipated by the parties. It should be pointed out that the *common* stockholders of Power, as well as the preferred stockholders, of Power, have definite legal and contract rights which must be respected. These rights are created by the charter itself and by the laws of Maryland to which the charter is subject. If the substance (and not the mere form) of the action here involved controls the rights of the parties, as we believe it should, it is clear that the plan does not violate any contract or legal rights of the preferred stockholders. Under Maryland law, a recapitalization or reorganization to accomplish the purposes to be accomplished by the plan here involved could be consummated with the consent of the holders of a majority of the stock of each class; and the charter provision governing the rights of the parties upon voluntary or involuntary liquidation would have no bearing on the matter. In effect, Otis & Co. asks this court to

disregard all legal and contract rights of the *common* stockholders and to consider only one contract right which the preferred stockholders would have upon the happening of an event which is not in fact taking place.

SUMMARY OF ARGUMENT.

I. The plan approved by the Commission and the courts below was "fair and equitable" and "appropriate to effectuate the provisions of Section 11" of the Act in accordance with the requirements of said Section 11.

II. The "absolute priority" rule, as applied in the bankruptcy cases, which is relied upon by petitioner, does not control the discretion of the Commission in approving a plan designed to readjust the corporate structure of a continuing enterprise in order to meet the requirements of the Act.

III. "Fair and equitable" under the Act is not a formula but a standard for the exercise of administrative discretion. The objection of the owner of 10 shares of preferred stock out of 600,000 shares should not prevail over the judgment, as to what is "fair and equitable", of the owners of 599,990 shares (expressed by their silent assent), the judgment of the corporate management, the opinion of the Commission, and decision of the District Court supported by the review of the Circuit Court of Appeals.

ARGUMENT.

I.

The plan approved was "fair and equitable" in accordance with the requirements of the Act.

The major contention of petitioner is that all common stock of Railways should be distributed to the preferred stockholders of Power because the charter of Power provides that, "upon the dissolution or liquidation of the corporation whether voluntary or involuntary," the holders

of preferred stock shall receive $100 per share plus accumulated dividends before any payment is made to the holders of the common stock. (R. 37) Since the asset value of Railways' common stock was not found to be equal to the total principal claim of the preferred stock, $60,000,000, plus a claim for accumulated dividends amounting to $38,700,000, it is the contention of petitioner that the entire common stock of Railways should be distributed to the preferred stockholders of Power. The Commission, however, approved of a distribution of 94.52 per cent of Railways' common to Power's preferred stockholders and 5.48 per cent to Power's common stockholders.

The majority opinion of the Commission held that "the 'fair and equitable' standard does not require us to consider liquidation rights as having matured, and as the sole measure of participation for the preferred stockholders." The opinion continues:

> "More specifically, if a class of preferred stock has a measurable interest in an enterprise absent the maturing of liquidation preferences and a proportionately greater interest upon the maturity thereof, it would not be fair or equitable under the statute to give recognition to the greater interest at the expense and to the detriment of the common stock. And conversely, if the common stock has a measurable interest apart from the maturing of liquidation preferences, we must not sanction the destruction of that interest through the operation of the statutory mandate." (R. 14)

The Commission explains further its disagreement with the dissenting Commissioner and with the argument of petitioner, as follows:

> "It is pointed out in Commissioner Healy's separate opinion that the words 'fair and equitable' embodied in Section 11 have a settled meaning, as determined by the courts, and that an application of the 'absolute priorities' doctrine must result in no distribution to Powers' common stock in this case. But that is because he measures the rights of the preferred stock

> as they would be measured in bankruptcy cases, and not merely because he follows the 'absolute priorities' doctrine in determining the consequences of the measurement. In other words, we can agree with him when he says that absolute priorities must be respected, because we think that doctrine simply means that the common stock must not be accorded any participation unless the preferred stock has been fully compensated for its rights and priorities. But there the area of agreement stops, because he says further that the rights and priorities of the preferred stockholders are the same here as in bankruptcy cases, where their claims to liquidation preferences (including dividend arrearages) are treated as matured. In our view it would be unconscionable and contrary to the plain intention of Congress to so hold." (R. 16)

The foregoing quotations express succinctly the principal issue in the present case. We face at the outset the question as to whether, first, this is a case of dissolution or liquidation of the corporation which was contemplated in the charter provision establishing the rights of the holders of preferred stock upon dissolution or liquidation. It seems evident that it was the intent of the charter provision to provide protection for the preferred stockholders, first in the event that the management of the corporation undertook a voluntary dissolution or liquidation in the ordinary sense; that is, decided to go out of business; or, second, if the management found itself in difficulties and because of the insolvency of the corporation had to liquidate and dissolve it. Certainly there was no thought that the preferred stockholders would have a right to squeeze out the common stockholders if, because of a requirement of the law, it became necessary for the company to be merged or consolidated with another company, or to be eliminated as one of a system of companies in a reorganization which continued the enterprise and the stockholders' investment therein.

We submit that the proposed action is neither a voluntary nor an involuntary dissolution or liquidation as those

words are used in the charter. It is neither a liquidation nor a dissolution of an enterprise, in substance or in fact. It is obviously not a voluntary action; but it is not involuntary in the sense of something compelled as the result of failure or weakness of management. It is not the sort of dissolution or liquidation contemplated by the charter, which would mean the winding up of the business. It is rather a compulsory reorganization to comply with a requirement of law not in contemplation of the parties when the charter was framed and the rights of the preferred stockholders were established. Essentially we have here the frustration of a contract caused by an act of government.

Frustration of a Contract.

It is a well established principle that where the fulfillment of a contract has been made impossible by the exercise of governmental power, exact performance will not be compelled, because the venture has been frustrated. (Restatement of Contracts, Pars. 460, 461.) This principle has been applied in the very case of the dissolution of The United Light and Power Company leading to a judicial decision that upon the retirement of the debentures of this company the debenture holders were not entitled to the payment of a premium in addition to the principal and accrued interest on the bonds. In that case, the Circuit Court of Appeals for the Second Circuit held as follows:

> "Where, through no fault of either party, something necessary for the continued performance of a contract goes out of existence because of some unforeseen circumstance and none of the parties have assumed that risk the contract is regarded as charged with the implied condition that if what is necessary to performance becomes unavailable the contract is no longer binding and further performance is excused. Texas Company v. Hogarth Shipping Co., 256 U. S. 619, 41 S. Ct. 612, 65 L. Ed. 1123; Chicago, Milwaukee & St. Paul R. Co. v. Hoyt, 149 U. S. 1, 13 S. Ct. 779, 37 L. Ed. 625. This is especially true where, as here, the

essential existence of one of the parties to a contract has become illegal and impossible because contrary to a new concept of public policy which was unforeseeable when the contract was made. Holyoke Water Power Co. v. American Writing Paper Co., 300 U. S. 324, 57 S. Ct. 485, 81 L. Ed. 678; Louisville & Nashville R. R. v. Mottley, 219 U. S. 467, 31 S. Ct. 265, 55 L. Ed. 297, 34 L. R. A. N. S., 671." (*New York Trust Company et al. v. Securities and Exchange Com. et al.*, 131 F. (2d) 274, 276) Certiorari denied, 87 L. Ed. Adv. Op. 819, 904.

Of course, in the foregoing case there was a liquidation in fact of the investment of the debenture holders. They were being paid off and their interest in the enterprise terminated. In the present case, the preferred stockholders are not demanding, nor could they be paid, $100 per share and a sum of money equivalent to all accumulated dividends. Nor would the preferred stockholders desire to have the assets sold and the resulting money distributed among them. The preferred stockholders are in thorough accord with the program whereby the debentures and other debts of the corporation are to be paid and then the remaining asset, the common stock of Railways, is to be distributed. In this way, the preferred stockholders maintain their interest in a continuing enterprise. So a question is presented, which is, not the right of the preferred stockholders in an actual dissolution and liquidation of the business in which the corporation is engaged, but the question of what is their fair and equitable share in a continuing enterprise from which simply the corporate entity of Power has been eliminated.

Contract Rights of All Stockholders.

We are here concerned not only with the contract or legal rights of the preferred stockholders, but also with the rights of the common stockholders derived from the provisions of the company's charter and the laws of the State of Maryland. At the time these stockholders invested their funds

in this enterprise, these rights were valid and enforceable rights and we must here consider how these rights have been affected or must be modified as the result of the requirements of Section 11 of the Act. It is not a fair and equitable position to assert that all the rights of the common stockholders have been wiped out and nothing remains to consider but the rights of the preferred stockholders. What is necessary under the law is a fair and equitable adjustment of the interests of all stockholders in view of their respective rights. Let us summarize these.

The principal rights of the preferred stockholders include:

(a) The right to receive $3,600,000 per year in dividends plus any arrears in such dividends before any dividends are paid on the common stock.

(b) The right to certain preferences in the distribution of assets in the event of liquidation or dissolution of the type contemplated at the time the contract was entered into, whether such liquidation or dissolution be voluntary or involuntary.

(c) The right, granted by the laws of Maryland and exercisable by negative vote or by failure to vote, to veto a plan of recapitalization proposed by the common stockholders.

The principal rights of the common stockholders include:

(a) The right to select the management of the Company and to control the Company's affairs whether or not dividends are paid on the preferred stock and without limit as to time.

(b) The right to receive all dividends paid by the Company in excess of $3,600,000 a year.

(c) The perpetual right to use the capital contributed by the preferred stockholders in the conduct of the Company's affairs.

(d) The right to eliminate the preferred stockholders from future participation in earnings by payment of a stipulated redemption price.

(e) The right to continue the business enterprise without limit as to time, provided insolvency does not intervene, which stated negatively, is a right *not* to liquidate.

(f) The right, exercisable by vote or failure to vote, to defer or prevent a recapitalization unless the terms are satisfactory to the common stockholders, which right includes the right to continue operations under the present capital structure no matter how remote may be their prospect of participating in a distribution of earnings.

All the foregoing rights, including those of the preferred stockholders and those of the common stockholders, must yield to the Holding Company Act to the extent that they are inconsistent with the provisions thereof requiring simplification of holding company systems and redistribution of voting power. Thus, solely as a result of congressional action, for which neither party was responsible, the rights of preferred and common stockholders to continue the present capital and corporate structure have terminated. The burden of this congressional condemnation must be borne equitably between the parties, and the Congress specifically so provided by laying down the standard that readjustments required by the Act must be "fair and equitable to the persons affected." (Sec. 11(e))

The court, in the debenture case (131 F. (2d) 274, quoted *supra*), held that where a contract has been frustrated or rendered impossible of performance because of the intervention of the Holding Company Act, senior security holders cannot be enriched at the expense of junior security holders. In that case the debenture holders had a contract right to hold their debentures until 1973 and to collect interest thereon until that date, or an alternative right to receive a premium if the debentures were sooner paid at the election of the company. The stockholders had no contract right to require the debenture holders to accept payment of their debentures prior to the stipulated maturity date. However, the stockholders did have the contract right

to use the bondholders' money until 1973. All of these rights had to yield to the Holding Company Act; and the Commission and the court very properly held that one contract right (the right of the bondholder to collect interest until 1973) could not be enforced in such a manner as to injure the stockholders who had likewise been deprived of their contract right (the right to use the money until 1973).

The rights of both the common and preferred stockholders to insist upon a continuation of their contract or legal rights has ceased because of the Holding Company Act and the Commission's action thereunder. If this event was "unforeseen" by the stockholders and the bondholders, as it was held to be in the debenture case, it was equally "unforeseen" by different classes of stockholders. Under these circumstances, the words "fair and equitable" must mean that existing rights shall be translated into new rights in a manner which will preserve equitably all the existing interests. In brief, the words "fair and equitable" do not permit or require the enforcement or acceleration of a *single* contract right in a manner which will destroy *other* contract rights. Particularly is this so where it appears that the contract right to be enforced or accelerated was not inserted in the contract for the purpose of meeting a contingency of the type which has occurred.

The Commission in effect held that under the existing contract rights the common stockholders have a chance of participating in future earnings without violating the contract rights of the preferred stockholders. The preservation of this right under a revised capital and corporate structure does not involve the transfer of value from the preferred stockholders to the common stockholders. The only feasible way to preserve the common stockholders' right to participate in future earnings is to grant them a portion of the common stock of Railways.

Having in mind the extent to which the Holding Company Act has destroyed the many valuable rights heretofore possessed by the common stockholders, it would seem highly

unreasonable to insist that their right to share in future earnings should also be destroyed. While the Holding Company Act requires the destruction of certain rights of the common stockholders, such as exclusive voting rights, it does not require or permit destruction of rights to participate in future earnings in a case where it is clearly demonstrated that such a right exists. The Commission's conclusions with respect to earning power clearly demonstrate that the common stockholders do have a right to share in those earnings, and for that reason we submit that the preservation of that right does not in any way conflict with the application of the "absolute priority" doctrine.

What is Really "Fair and Equitable"?

To get a clear view of what is fair and equitable, let us consider what would have happened if the management of Power, not under any compulsory requirement, had undertaken to simplify the corporate structure of this holding company system by eliminating Power and distributing the shares of Railways among the preferred and common stockholders of Power. How would the respective claims of the preferred and common stockholders have been appraised? The record shows that the preferred stockholders contributed $60,000,000 in cash. The common stockholders contributed $28,482,745. (R. 72) There were dividends paid of $8,752,796 to common and $10,538,118 to preferred. Even if we deduct the dividends paid to common (but do not deduct the dividends paid to preferred) the common has made a net contribution of $19,729,949.

It also appears (R. 19) that during the period from 1929 through 1942 undistributed consolidated earnings amounted to $51,525,951. If $38,700,000 be deducted to cover accumulated dividends on Power's preferred stock, the balance, $12,825,951, would be applicable to Power's common stock. Thus we find in the enterprise a contribution of original cash ($60,000,000) and unpaid dividends by preferred stockholders amounting to $98,700,000 and an original con-

tribution of $28,482,745 by common stockholders, minus dividends ($8,752,796), plus earnings plowed in ($12,825,951)—a total of $32,555,900.

In the face of these facts regarding the capital contributions of the respective stockholders, would anyone suggest that, upon a reorganization to simplify the corporate structure, the referred stockholders should receive all the assets, that is, all the common stock of Railways, and the common stockholders should receive nothing? No such proposition could be presented by the corporate management with any expectation that it would be regarded as a fair and equitable division; and unless it was so regarded by the common stockholders, they, by exercising their contract and legal rights under the charter and laws of Maryland, could prevent its consummation.

The record shows that, in an effort to comply with the requirements of the Act, the management submitted to the Commission in 1940 a plan of recapitalization and simplification, in accordance with which the preferred and common stocks of Power were reclassified into a single class of new common stock divided substantially as follows: 91.20 per cent to the preferred stockholders; 6.13 per cent to Class A common stockholders and 2.67 per cent to Class B common stockholders. The Commission, however, later instituted proceedings in which the plan of recapitalization and simplification was put aside and an order entered on March 20, 1941 requiring the liquidation and dissolution of Power. In presenting its plan in response to the order of the Commission, the management of Power proposed the same division as in its reorganization plan. The Commission required the share of the preferred stockholders to be increased to the present approved amount of 94.52 per cent.

Looking back over this history, is it not evident that any plan for the reorganization of this enterprise which would wipe out all interest of the common stockholders, notwithstanding their heavy cash investment, could not be regarded as "fair and equitable" in accordance with any or-

dinary understanding of the meaning of those words? The petitioner in the present case is therefore reduced to the necessity of contending that the words "fair and equitable" have an artificial meaning and that according to the absolute priorities rule an unfair and inequitable distribution of all the assets to the preferred stockholders is required.

Now the Commission did not refuse to follow the absolute priorities doctrine. The majority agreed with the dissenting commissioner "that absolute priorities must be respected." But the majority did not agree that "the rights and priorities of the preferred stockholders are the same here as in bankruptcy cases, where their claims to liquidation preferences (including dividend arrearages) are treated as matured." Such a construction of the absolute priorities rule, in the language of the Commission, "would be unconscionable and contrary to the plain intention of Congress." (R. 16)

Before we undertake to discuss the absolute priorities rule, let us consider the intention of the Congress as shown in the language of the Act.

It was certainly the major intention of the Act to protect the interests of investors, not to despoil investors, nor to destroy the value of investments.

In Section 11, it was made the duty of the Commission to simplify the corporate structure of holding company systems, to distribute voting power fairly and equitably, and to confine the properties and business of a system to those necessary and appropriate to the operations of an integrated public utility system. The plan for simplifying a system and conforming it to legal requirements is described in Section 11(d) as "a fair and equitable reorganization plan"; and throughout the section, the words "reorganization plan" and "reorganization" are repeatedly used. The plan presented by Power in the present case, and approved by the Commission, was only one step in a broad reorganization plan. It was only a liquidation and dissolution in the sense that, in the consummation of the

plan, the corporate entity entitled "The United Light and Power Company" would be eliminated. But the plan provides that the investors in that company shall continue in ownership of the same properties which they had owned through the medium of the eliminated corporation. To treat such a reorganization as a bankruptcy liquidation would do violence to the purpose of the Act and be contrary to the fact.

Obviously, the requirement of the Act, that the Commission's approval should be based on a finding that the plan is "fair and equitable to the persons affected by such plan" had a larger meaning than that the Commission should proceed to distribute the assets of a corporation to be eliminated on the same basis as though the corporation had become bankrupt, and as though, not only the corporation but, the entire enterprise had to be liquidated. This Court has defined the meaning of the phrase "fair and equitable" in this section of the law as follows:

> "Determination of what is 'fair and equitable' calls for the application of ethical standards to particular sets of facts, but these standards are not static. In evolving standards of fairness and equity, the Commission is not bound by settled judicial precedents. Congress certainly did not mean to preclude the formulation by the Commission of standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time the Public Utility Holding Company Act of 1935 became law. But the Commission did not in this case proffer new standards reflecting the experience gained by it in effectuating the legislative policy. On the contrary, it explicitly disavowed any purpose of going beyond those which the courts had heretofore recognized. Since the Commission professed to decide the case before it according to settled judicial doctrines, its action must be adjudged by the standards which the Commission itself invoked. And judged by those standards, i.e., those which would be enforced by a court of equity, we must conclude that the Commission was in error in deeming its action controlled by established judicial

principles." (*Securities and Exchange Commission* v. *Chenery Corporation*, 318 U. S. 80, 89; 87 L. ed. 411)

Let us now examine the cases upon which the petitioner relies in its insistence that the absolute priority rule be applied in reorganizations under the Holding Company Act in the same manner in which it is applied in the bankruptcy cases.

II.

The absolute priority rule of the bankruptcy cases does not control the Commission's discretion in approving a plan as fair and equitable.

The application and limitations of the absolute priority rule can be determined in the light of the two cases particularly relied upon by petitioner. The first is *Case* v. *Los Angeles Lumber Products Company*, 308 U. S. 105. In that case, the Court held (at page 115), in construing a reorganization under Section 77B of the Bankruptcy Act that:

> "The words 'fair and equitable' as used in Section 77B(f) are words of art which prior to the advent of Section 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations. Hence, as in the case of other terms or phrases used in that section, (citations) we adhere to the familiar rule that where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary." (Citation)
>
> "In equity reorganization law the term 'fair and equitable' included, inter alia, the rules of law enunciated by this Court in the familiar cases of (citations). These cases dealt with the precedence to be accorded creditors over stockholders in reorganization plans. * * *"

It is quite evident from a reading of the entire opinion that the absolute priority rule which must be observed in any

"fair and equitable" distribution of assets established the principle expressed by the Court (page 120) as follows:

> "* * * 'to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation,' * * *"

It will be at once noted that the rule was not applied to a distribution between stockholders. The preferred stockholders are not creditors of the corporation, but share its ownership with the common stockholders. Their rights to preference over the common stockholders do not arise from an indebtedness of the corporation (i.e., the common stockholders) to them, which should be paid before there is any property left to be distributed to the owners. On the contrary, their rights to preference arise out of contractual relations between the preferred and common stockholders which the Commission is given specific power to reform. For example, in a reorganization, the Commission can take away completely the exclusive voting rights of common stockholders. The contractual rights of the parties cannot be enforced against a finding of the Commission that the exercise of such rights would be in conflict with the requirements of the Act. Thus, the government has to a considerable extent frustrated the original contract between the stockholders. Under the circumstances, the determination of the Commission as to what is fair and equitable cannot be controlled by insistence upon the enforcement of a contract.

It should be apparent that the absolute priority rule laid down in *Case* v. *Los Angeles Lumber Products Company*, *supra*, cannot be held binding upon the Commission so as to control the exercise of its discretion in determining whether the plan for the distribution of the assets of Power between preferred and common stockholders is fair and equitable.

But it is asserted by counsel for petitioner that this Court has held in *Consolidated Rock Products Co.* v. *Du*

Bois, 312 U. S. 510; 85 L. ed. 982, that the absolute priority rule applies to reorganizations of solvent, as well as insolvent, companies. The Court did so hold, and we quote from the opinion at page 527:

> "* * * Whether a company is solvent or insolvent in either the equity or the bankruptcy sense, 'any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights' of creditors 'comes within judicial denunciation.'"

So here again we find the definite limitation of the absolute priority rule and the requirement that it be observed in determining whether a reorganization plan is "fair and equitable." The Commission, in the present case, was not concerned with the need to satisfy in full the claims of creditors before permitting any distribution to stockholders. The creditors have been satisfied. The question is, what is a fair and equitable distribution of the assets among stockholders whose holdings all represent actual investments in a continuing enterprise?

The Commission rejected an over-all valuation of the property in a study prepared in behalf of the management by an independent engineer, which the company had brought down to April 30, 1942, reaching an over-all value of $110,000,000. (R. 9) The Commission also found that, by capitalizing prospective earning power, they could not on a "reasonable basis" arrive at a valuation equal to $98,700,000—the amount of the preference claim asserted by present petitioner. Nevertheless, the Commission did find that, on the basis of assumed annual earnings of $6,185,000, the preferred dividend arrearages might be paid in full in approximately fifteen years "if all consolidated net earnings were to be applied toward the payment of current and accumulated preferred dividends." (R. 24) So the Commission, viewing the elimination of Power, not as a liquidation because of financial embarrassment, but as the reorganization of a continuing enterprise, concluded

that the common stock was entitled to some participation, keeping in mind, as was stated, "that there is always a margin of error inherent in any estimate of earning power." (R. 25)

Although the Commission described its estimate of future earning power as "very liberal," attention should be called to the management estimate of $7,000,000 (R. 11), which, in view of pre-depression income and the income of recent years, was not unreasonable. But even accepting the estimated $6,185,000 (which seems more pessimistic than liberal), we point out that 95% of this income will give the preferred stock a 5.95% return on its full claim of $98,700,000—of which $38,700,000 are dividend arrearages, a non-interest bearing claim. Since the Commission's "margin of error" is more likely to be an underestimate than an overestimate of future earning power, we submit that the Commission's conclusion that the common stock was entitled to some participation is fully justified and that its administrative judgment should not be set aside.

It is made plain that the judgment of the Commission as to a fair and equitable division of the interests of preferred and common stockholders in a continuing enterprise was based, first, on the proposition that "the accumulation of preferred dividend arrearages does not constitute a matured claim in the absence of liquidation" (and that this was not a liquidation of the *enterprise* nor the corporate liquidation contemplated in the charter) and second,—

> "To accelerate the arrearages and translate them into matured claims at their full face amount, so as to entitle the preferred stock not only to all the assets but also in perpetuity to the entire earning power of those assets—a portion of which would otherwise have been applicable to the common stock—would clearly be to enrich the preferred at the expense of the common.
>
> "Under the circumstances, fair and equitable compensation will be given to all of the claimants if their rights are measured not in terms of the situation created by the statute but rather in terms of the situation terminated by it—i.e., as though no liquidation were to

take place. In this way each class of stock will be accorded its proportionate share of the benefits to be gained from the elimination of a useless and expensive corporate entity and from the receipt of a security representing a more direct investment in the underlying assets and earnings of the system." (R. 18)

In the opinion of this Court in *Consolidated Rock Products Company* v. *Du Bois*, *supra*, at page 526, a quotation was made with approval from an opinion of Mr. Justice Holmes, in which he stated, "the commercial value of property consists in the expectation of income from it," and the Court went on to hold:

"* * * The criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants is to be fair and equitable."

In approving the plan involved in the present case, the Commission found that it could not capitalize prospective earning power so as to reach a value of the property which would cover the claim of the preferred stock of $98,700,000 based on capitalizing $38,700,000 of preferred dividend arrearages. But the Commission held that it would be unfair and inequitable to accelerate the arrearages and translate them into a matured claim in an enterprise which was not being liquidated but continued. Then the Commission found that the prospective earning capacity of the enterprise was sufficient to provide in effect for paying preferred dividends and paying off arrearages in approximately fifteen years, which, if the entire assets were transferred to the preferred stockholders, would mean they would receive for a $60,000,000 investment a property of much greater value, having squeezed out the common stockholders, who, as previously shown, had contributed initially over $28,000,000 and subsequently over $12,000,000 of plowed-in earnings to the up-building of this property.

Under these circumstances, when the Commission found that it would be fair and equitable to allow a distribution of approximately 5 per cent to the common stockholders, it would seem that the only persons who could object to unfairness and inequity, would be the common stockholders. It is not surprising that the owners of all but 10 shares out of 600,000 shares of preferred stock have made no protest against the plan.

III.

Fair and equitable is not a formula but a standard for the exercise of administrative discretion.

In this argument in behalf of the respondent, Power, we have not questioned the soundness of the ruling of the Supreme Court that the words "fair and equitable" as used in Section 77B(f) of the Bankruptcy Act are words of art and that they establish an absolute priority in favor of creditors in the reorganization of a corporation whether solvent or insolvent. We do not question the proposition that a plan of reorganization and simplification under Section 11 of the Public Utility Holding Company Act of 1935 must provide for the full satisfaction of *creditor* claims before the distribution of assets or allocation of interests to corporate owners. It is, however, our contention that, when a distribution of assets and allocation of interests in a continuing enterprise to the original owners is to be made, the standard of "fair and equitable" does not require either the acceleration of preferred dividend arrearages or the satisfaction of a theoretical claim of the preferred stock to a cash payment which cannot be made, by substituting an arbitrary valuation of assets based on their presently assured earning capacity. We submit that, in the adjustment of the respective claims of investors holding common and preferred stock, and in estimating the future earning capacity of the continuing enterprise, the Commission has been invested with a large discretion to determine what is

fair and equitable, not in accordance with any rigid formula but in accordance with its informed judgment.

We also submit that as a practical matter, the approval by the Commission of a plan which is almost unanimously accepted by all the stockholders concerned should determine conclusively that the plan is fair and equitable when there is no rigorous rule of law to coerce the judgment of the Commission, and particularly when the same readjustment of the interests of the stockholders could be carried through under state law without violating any of the contract rights of any of the stockholders.

CONCLUSION.

We submit that the findings of the Commission and the opinions of the District Court and Circuit Court of Appeals demonstrate, first, that there is no violation of the absolute priority rule in the plan approved and, second, that the plan approved was, both in a legal sense and in common sense, fair and equitable.

Respectfully submitted,

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No. 993

In the Supreme Court of the United States

OCTOBER TERM, 1943

OTIS & CO., PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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The respondent Securities and Exchange Commission, does not oppose the petition of Otis & Co. that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered April 20, 1944.

OPINIONS BELOW

The findings and opinion of the Securities and Exchange Commission (R. 3, 87), not yet officially reported, are set forth in the Commission's Holding Company Act Release No. 4215. The opinion

of the United States District Court for the District of Delaware (R. 94) is reported in 51 F. Supp. 217. The opinion of the United States Circuit Court of Appeals for the Third Circuit (R. 144) is not yet reported.

JURISDICTION

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered April 20, 1944 (R. 164). The petition for a writ of certiorari was filed May 11, 1944. The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925, the provisions of which are made applicable by Section 25 of the Public Utility Holding Company Act of 1935 (the "Act"; 49 Stat. 803, 15 U. S. C. § 79a *et seq.*).

QUESTION PRESENTED

Pursuant to an order of the Securities and Exchange Commission under Section 11 (b) (2) of the Act, requiring The United Light and Power Company ("Power") to liquidate and dissolve (R. 139), Power took steps to satisfy the claims of all creditors. Thereafter, Power presented to the Commission for approval as "fair and equitable" under Section 11 (e) of the Act a plan allocating among Power's preferred and common stockholders the common stock of its subsidiary holding company to which will be transferred all of Power's remaining assets.

Although the present value of Power's assets is conceded to be less than the charter liquidation preference of Power's preferred stock, including arrears, the Commission found that the prospects for future earnings are such that, absent the corporate simplification requirements of the Act and assuming that Power should continue with its existing security structure, the arrears of dividends could be discharged, affording an ultimate prospect for resumption of dividends on the common stock. The Commission concluded that an allocation of the common stock of the subsidiary on the basis of 95% to the preferred and 5% to the common stock of Power approximately reflects their relative interests in the existing security structure (R. 20–32).

The question presented is whether in applying to such a plan the "fair and equitable" standard prescribed in Section 11 (e) the Commission erred in determining the proper allocation of securities upon the basis of the entire bundle of rights of both classes of Power's stock, with primary reference to their relative expectations of participating in income under the existing structure, rather than exclusively upon the basis of the charter liquidation preference of Power's preferred stock.[1]

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[1] The question is solely whether the common stockholders of Power are entitled to any participation in the new securities. No question is raised as to the particular amount of participation approved by the Commission.

STATUTE INVOLVED

The applicable provisions of the Act are set forth in the Appendix, *infra*, pp. 26–29. The substance of the relevant statutory provisions is as follows:

Under Section 11 (b) (2) of the Act, it is the duty of the Commission to require all registered holding companies and their subsidiaries to "take such steps as the Commission shall find necessary" to simplify the structures of their holding company systems and to correct the distribution of voting power. One specific instance of undue complications the correction of which is mandatory is the situation where there are more than two tiers of holding companies in violation of the "great grandfather" provision.

To enable the Commission to *compel* compliance with its orders issued under Section 11 (b) (2), the Commission is authorized by Section 11 (d) of the Act to resort to the district courts for enforcement thereof; and the courts are empowered, *inter alia*, to dispose of the corporate assets "in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing."

To enable companies subject to Section 11 (b) (2) to effect *voluntary* compliance with the requirements of that section, Section 11 (e) of the Act permits companies to "submit a plan to the

Commission for the divestment of control, securities, or other assets, or for such other action" as will enable the companies to comply. The Commission, after notice and opportunity for hearing, is authorized to consider whether the plan is "necessary to effectuate the provisions of subsection (b)[2] *and fair and equitable to the persons affected by such plan,*" and if the Commission so finds, to make an order approving the plan. Thereafter, the Commission is empowered, at the request of the company, to apply to a district court "to enforce and carry out the terms and provisions of such plan." The court, after notice and opportunity for hearing, is authorized to "approve such plan as *fair and equitable* and as appropriate to effectuate the provisions of section 11"[3] and is vested with jurisdiction to enforce the plan so approved.

STATEMENT

(a) *Proceedings below.*—Pursuant to Section 11 (e) of the Act, the Commission, at the request of Power, applied to the United States District Court for the District of Delaware to enforce a plan which, as modified (R. 112) the Commission had approved after a hearing (R. 3, 87, 89). The district court, after notice and hearing (R.

[2] No question was raised in the present case as to the findings that the plan was necessary and was appropriate to effectuate the provisions of Section 11.

[3] See footnote 2. [Italics supplied.]

141), approved the plan by judgment entered August 4, 1943 (R. 109). On appeal by Otis & Co., a preferred stockholder and an intervenor in the district court, the circuit court of appeals unanimously affirmed the judgment of the district court (R. 144, 164).

(b) *The Factual Basis of the Commission's Order.* Power, a registered holding company at the top of a system which embraced 52 companies, including 7 registered holding companies, was found by the Commission to violate the requirements of Section 11 (b) (2), and particularly the "great grandfather" provision (R. 129–130). On March 20, 1941, the Commission ordered Power to proceed with due diligence to liquidate and dissolve (R. 139). The decision to liquidate Power rather than to pursue alternative avenues to the simplification of the system was based on considerations of economy and convenience apparently dictated by the best interest of all classes of Power's security holders (R. 10–17). No proceedings to review that order were ever taken. Thereafter the Commission approved various applications by Power to carry out steps necessary to the required liquidation.

As the final step in the liquidation program, Power submitted to the Commission a plan (Application No. 14) to retire its remaining debt, to transfer miscellaneous assets as a capital con-

tribution to its chief subsidiary holding company, United Light and Railways Company ("Railways"), and to distribute Power's remaining asset, the common stock of Railways, to Power's preferred and common stockholders, by allocating 91.2% thereof to Power's preferred stockholders and 8.8% to its common stockholders (R. 4–9).

Evidence was taken upon the plan. The basic problem before the Commission was how to distribute the common stock of Railways fairly and equitably between Power's two classes of stockholders. One factor considered by the Commission was that the preferred had a preferential right by charter to receive $100 per share plus $64.50 accumulated dividends (as of December 31, 1942) on "voluntary or involuntary" dissolution or liquidation, or an aggregate of $98,700,000, including dividend arrearages, on the outstanding 600,000 shares, before any payment might be made to the common (R. 11). All members of the Commission concluded that the value of Railways' common stock was less than the liquidation preference of the preferred, and, if the sole basis of allocation were the charter liquidation preference, then Power's common stockholders could take nothing (R. 11–13, 53).

The factual analysis used by the majority of the Commission went beyond this point, however. The majority considered the past earnings of Power and Railways, on both corporate and con-

solidated bases with adjustments for certain nonrecurring items, in order to arrive at an estimate of the future earning power of Railways' common stock. Power's corporate income since 1932 had been less than the annual preferred dividend requirement of $3,600,000, but the consolidated net income had fluctuated widely, and over the period of 1932–41 had produced a net balance in excess of the current requirements of Power's preferred stock of over $18,000,000. The bulk of the consolidated earnings had not, however, been taken up into Railways or Power, and no dividends had been paid on Power's preferred or common stocks since 1932. Consolidated earnings applicable to the common stock of Railways for the period 1937–41, subject to adjustments for certain nonrecurring expenditures, averaged in excess of $6,000,000 per annum, and for the period 1937–42 had exceeded $6,184,000 as an annual average. (R. 19–32.)

From the foregoing and the management's testimony as to estimated future earnings, the majority of the Commission concluded that future annual earnings of $6,185,000 might be attributed to Railways' common stock, for the purpose of determining the existing rights of Power's preferred and common stocks in the enterprise (R. 30). This figure was considered, however, to be a "very liberal assumption" and was to be discounted accordingly (R. 30–31). On this basis, and assuming that all consolidated net earn-

ings might be applied to the payment of current and accumulated preferred dividends (again, an assumption which the Commission discounted as overliberal), it would take approximately 15 years to pay off Power's preferred dividend arrearages (R. 30).

The majority of the Commission emphasized the remote character of the common stockholders' interest and for that reason disapproved the company's proposal to allocate approximately 9% of the common stock of Railways to the common stockholders of Power (R. 30–31). Nevertheless it was concluded that, absent liquidation or reorganization to comply with Section 11, there was a reasonable possibility that, on the basis of its existing capital structure, Power would ultimately pay off the preferred dividend arrearages and place the common stock on a dividend-paying footing. This possibility was deemed sufficiently substantial to justify a lesser allocation to the common stock than had been proposed. With respect to the size of the allocation, the majority considered the question as "of necessity one of over-all judgment and not susceptible of mathematical demonstration," and held that a participation of approximately 5%, "while representing the maximum, would not exceed the permissible limits of fairness." (R. 31–32.)

Thus, in effect, the Commission was considering Power's situation as it might exist, absent reor-

ganization, some 15 years hence, after the preferred dividend arrearages should be paid. At that time the preferred would be limited to an annual dividend of $3,600,000, and 100% of all the additional earnings would be applicable to the common. Under the Commission's suggestion of a 5% participation for the common stock of Power, the common stockholders would surrender their 100% future interest in the estimated $2,585,000 of excess annual earnings to begin at that time, in exchange for a 5% interest in the entire estimated annual earnings of $6,185,000 (or $309,250) beginning at once. In return, the preferred stockholders would surrender approximately 5% of their exclusive interest in all earnings during the 15-year period and in the first $3,600,000 of income thereafter, in exchange for a new right in perpetuity to 95% of the estimated excess annual earnings beginning at the expiration of the 15 years.[1]

The difference between what the common stockholders would surrender after elimination of

[1] This analysis concededly involves some over-simplification. We are speaking of estimated consolidated earnings which would not as a practical matter be entirely distributed in dividends. To the extent that such earnings would be retained in the business, the amount immediately payable would necessarily be reduced, thereby delaying progress in discharging the dividend arrears. How much these factors would ultimately affect the amount available for the common stock after the dividend arrears should be paid and the time required to pay off arrears would depend upon the amount of additional income received from the earnings retained.

arrears and what they would receive under the Commission's suggested allocation (a ratio of about 8.4 to 1) indicates how the Commission appraised the advantage to the common stock of the elimination of the 15-year delay, the $3,600,000 annual preference of the preferred stock, and the risk that distributable earnings might prove less than the estimate. But for the inherent risk factor, the difference between the future interests which would be surrendered and the new interests presently to be received by the common stockholders is comparable to the difference between an annuity of $8.40 commencing 15 years hence and an annuity of $1 beginning immediately. To make these annuities mathematically equivalent, the larger would have to be discounted to present value at the rate of 15.2%. This very high discount rate measures the risk factor involved in the assumption by the majority of the Commission that Power's common stock had a reasonable prospect of receiving an estimated $2,585,000 annually beginning 15 years in the future, and offsets the "very liberal" character of the estimate of consolidated earnings.[5] Accordingly, the majority held that the allocation of 5% to Power's common stock was a fair alloca-

[5] The majority of the Commission pointed out that in a pyramided holding company system earnings are subject to wide fluctuations, and an increase of only a few percent in operating company earnings would be magnified into a very

tion taking account of the considerations involved. Commissioner Healy's dissenting opinion (R. 46) sharply disagreed with this conclusion.[6]

The plan was modified to allocate 94.52% of Railways' common stock to Power's preferred stockholders and 5.48% thereof to its common

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great improvement at the holding company level. The majority recognized a possibility, therefore, that future earnings might actually exceed even the "very liberal" estimates (R. 31).

Under Power's original plan of allotting 8.8% to the common stock, the common would have been given a present annuity of $544,280 in lieu of the future annuity of $2,585,000. This would have indicated a discount rate of 11%, a ratio which justifies the conclusion implicit in the Commission's rejection of Power's original plan that the common was being allotted too much in view of the risks involved.

[6] The principal factual points urged by Commissioner Healy against the use by the majority of the Commission of the $6,185,000 future earnings figure are:

(a) It is an estimate of consolidated earnings and not of corporate earnings of Railways available for its common stock. In prior years the corporate earnings have been substantially less than consolidated earnings.

However, the past record of corporate earnings is not necessarily the significant index for the future. Completion of the statutory simplification program will remove dividend blocks which have prevented the passing up of dividends of Railways' subsidiaries in the past and will restore managerial incentive so to do. Furthermore, any dividends not paid up will, as invested funds, produce earnings, and thereby ultimately increase system earnings.

(b) The adjustment of past earnings for nonrecurrent items is based upon too-liberal assumptions.

While this may be true, the liberality is compensated by the high discount rate implicitly used.

stockholders[7] (R. 112). With this modification the plan was approved by the Commission as fair and equitable (R. 87, 89).

DISCUSSION

(a) *The Legal Basis of the Commission's Order.*

(1) Although the "fair and equitable" standard embodied in Section 11 (e) is verbally the same as those "words of art" which this Court held in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, require application of the "absolute priority" doctrine developed in equity receiverships and reorganizations under former Section 77B of the Bankruptcy Act, the majority of the Commission concluded in the present case (R. 14–19) that the precedents for determining the participation of claims of creditors and others in such proceedings are not wholly applicable in dealing with a readjustment of rights of stockholders of a solvent company under Section 11 (e) of the Holding Company Act, because such precedents (R. 14):

> are predicated on sets of facts fundamentally distinguishable from the situation arising here. In bankruptcy or equity reorganizations * * * creditors and other claimants are prevented from foreclosing or otherwise compelling an actual

[7] The fractions resulted from an allocation of 5 shares of Railways' common for each share of Power's preferred and 1 share of Railways' common for each 20 shares of Power's common.

> liquidation, but new securities are distributed among them according to their contractual and other rights determined as though in liquidation. * * *
>
> On the other hand, Power is a company virtually without debt and under no financial embarrassment in the traditional bankruptcy or equity sense.

The majority of the Commission considered that this view was not a departure from the "absolute priority" doctrine which, it understood, requires full compensation for rights surrendered. *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U. S. 523, 565–66. Rather, the majority considered that the preferred stockholders of Power were receiving full compensation for what the majority deemed to be their "rights" in the context of this proceeding under the Act, and therefore were being accorded their "absolute priority." The only question was what are the "rights" for which the preferred stockholders are entitled to compensation. Thus, it was observed that the right surrendered in the bankruptcy reorganization is a claim, which has matured in accordance with the expectation of the parties, to the face amount of a debt security or to the liquidation preference of a senior stock. In contrast, the Commission is frequently required under Section 11 of the Holding Company Act to deal with unmatured claims, and here with an inchoate liquidation preference which,

apart from the statute, preferred stockholders had no right to mature (R. 14–18).[8]

The majority of the Commission interpreted the "fair and equitable" standard of Section 11 in the light of the entire Act, and its legislative history,[9] as intended to afford recognition, in the simpler security structures envisaged by the Act, to each class of security holders which has an interest in the existing structures—and not as intended to afford any class a windfall at the

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[8] Petitioner urges that there is no real distinction between reorganizations under the Act and bankruptcy reorganizations, and particularly that *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, dealt with the rights of stockholders *vis-a-vis* holders of income bonds which had not matured prior to the institution of the proceedings. However, the company had filed a voluntary petition under Section 77B and had admitted therein its insolvency, thereby invoking the ordinary bankruptcy principle which permits proof of claims whether matured or unmatured. The particular language from this Court's opinion quoted at page 18 of petitioner's brief must be read in its context as indicating only that a company filing a voluntary petition under Section 77B, and admitting its insolvency, cannot exact a price for that admission so as to entitle stockholders to a participation which would not have been warranted had creditors succeeded in instituting an involuntary proceeding. That decision has no relevance to the question whether the reorganization provisions of the present Act should be construed as intended to mature otherwise unmatured and inchoate liquidation preferences.

[9] Reference to this legislative background is cited in the Commission's opinion (R. 16–17) and additional materials appear in the opinion of the court below (R. 157–158). One of the documents referred to, namely Congressman Eicher's "additional views" appended to the House Report to accompany S. 2796, specifically emphasizes the distinction

expense of another. This conception does not permit holders of worthless common stock to capitalize on mere nuisance positions,[10] or permit the exaction of a toll for the surrender of inequitable voting rights proscribed by the statute.[11] On the other hand, it does not permit the preferred stockholders to treat their otherwise in-

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between the preservation of stockholders' equities and the maturing of liquidation rights:

"Long ago, under the Sherman Antitrust Law and under the commodities clause of the Hepburn Act, the courts worked out a technique which would permit readjustments and reorganizations, *without the acceleration of indebtedness or the maturing of rights upon liquidation*, to enable corporations to rearrange their corporate structures and divest themselves of properties to the extent required to comply with Government policy. The courts have even gone so far as to permit the equitable apportionment among several properties of a general mortgage lien theretofore attaching to those properties as an indivisible whole, without accelerating the maturity date of the mortgage, if the segregation of those properties is necessary to conform to the policy of the Federal statutory law (*Continental Insurance Co.* v. *U. S., Reading Co., et al.*, 259 U. S. 156). The allegation that the Senate bill will cut off valuable equities by the forced liquidation of assets and the dumping of securities upon a demoralized market are consequently not borne out by the provisions of the Senate bill or the judicial precedents established in analogous cases." H. Rept. No. 1318, 74th Cong., 1st Sess., pp. 49–50. [Italics supplied.]

[10] In *Federal Water Service Corp.*, 8 S. E. C. 893, 914 (1941) and *Southern Colorado Power Co.*, Holding Company Act Release No. 4501 (1943) the Commission excluded from participation common stocks having no reasonable prospect of ever receiving anything from the corporation.

[11] *Columbia Gas & Electric Corp.*, Holding Company Act Release No. 3885 (1942), affirmed on review, *sub nom. Marquis & Co.* v. *S. E. C.*, 134 F. (2d) 882 (C. C. A. 3, 1943).

choate claim to a liquidation preference (including dividend arrears) as a matured claim on the basis of which they may wipe out common stockholders if the present value of the assets happens to be less than the amount of that claim.

Since the Commission, on the basis of the analysis discussed *supra*, pp. 6–13, found (a) that, under the existing securities structure, there was a reasonable prospect of Power's ultimately receiving sufficient income to pay current and accrued dividends on the preferred and to resume payments on its common stock, and (b) that approximately 5% of the common stock of Railways distributable under the plan was the fair equivalent of that expectation, it arrived at the 95–5% allocation embodied in the plan.

(2) The circumstance that the statutory readjustment in this case took the form of a liquidation of Power as a separate corporate entity was considered by the majority not to be determinative (R. 13–17). Once having concluded that it is the purpose of the statute to preserve through "fair and equitable" plans equities of the type represented by Power's common stock, the Commission could not treat the order prescribing a particular form of reorganization as reducing the substantive rights of Power's common stockholders *vis-a-vis* the preferred by maturing the otherwise inchoate liquidation preference of the preferred. The liquidation of Power as a sep-

arate corporate entity was treated as a procedural mechanism for the reorganization and not as necessitating a different substantive result from that which would be fair and equitable in a recapitalization or merger. The choice of this particular procedure had been dictated upon purely practical grounds. It would have been possible, though less practical, to employ other mechanics including the merger or consolidation of Power and Railways, or a one-stock reorganization of Power, followed by dissolution. The choice of the most economical and expeditious method was in the interest of preferred stockholders and common stockholders alike, as well as in accordance with the mandate of Section 11 (b) that the Commission proceed "as soon as practicable." Under such circumstances, to permit the formal device chosen for the reorganization to determine substantive results would be bad public policy and bad law.

Granted that it was fair and equitable to utilize the liquidation of Power as a reorganization device without treating the charter liquidation preference as controlling, it is clear that this contract right was not beyond the reach of Congress under the commerce power. Thus, in *Continental Insurance Co.* v. *United States*, 259 U. S. 156, cited in the legislative history quoted *supra*, p. 16, n. 9, this Court said (p. 171) that "the power of the court under the Sherman Anti-Trust Law to disregard the letter and legal effect

of the bonds and general mortgage under the circumstances of this case, in order to achieve the purpose of the law, we cannot question." See also *Philadelphia, B. & W. R. Co.* v. *Schubert*, 224 U. S. 603.

The majority of the Commission concluded further that the refusal to give effect to the charter liquidation preference under the unique circumstances of the case would not disappoint any reasonable expectation of the preferred stockholders. As the Commission and the courts below pointed out (R. 13, 102–103, 156–157), the contingency which allegedly has matured the liquidation preference is one which could not have been anticipated by the parties when the stock was issued in 1929, before enactment of the Act. *Cf. Chicago, Milwaukee & St. Paul Ry. Co.* v. *Hoyt*, 149 U. S. 1, 15.

Finally, it was clear that the liquidation which the Commission had ordered was not the kind of dissolution of a business enterprise that would properly invoke the contractual liquidation preference of Power's preferred stock. As the opinion of the majority of the Commission discloses, the preferred and common stockholders of Power have been the residual co-owners of a vast public utility system controlled through Power, the top holding company, and Railways, its principal subholding company subsidiary. This they will continue to be, for the principal result accomplished by the Commission's order is to break off

one of the corporate shells through which their residual ownership was held, and to transform their interests into stock of the next corporate entity, Railways. In essence, therefore, while Power is being dissolved, the enterprise is not.

(b) *Importance of the Question in the Administration of the Act.*

While petitioner contends that the Commission's interpretation of the "fair and equitable" standard in this case conflicts with the "absolute priority" doctrine announced by this Court—and with this Court's decisions under the reorganization provisions of the Bankruptcy Act—it is the Commission's view that no such conflict exists. This case is, however, of substantial public importance because it is the first to be presented to this Court of a series of cases in which the Commission has applied the "fair and equitable" standard in determining the respective participations of preferred and common stockholders of a solvent company under a plan to effectuate the corporate simplification provisions of Section 11 (b) (2) of the Act.

In each of these cases the determination has been made after an evaluation of the entire bundle of rights of the old classes, but with primary reference to their expectations of participating in future income under the existing financial structure. This view has been maintained whether the

plan involved a merger[12] or a recapitalization.[13] The common denominator in all the plans involved in these cases has been a provision for continuation of the enterprise either by the same or by a new corporation, but with a single class of stock substituted for two or more preceding classes. Specifically, the Commission has held that where a class of junior stock has a reasonable expectation of participating in future income under the existing security structure, it must receive the equitable equivalent of this interest in the form of securities distributable under a plan, notwithstanding the fact that the present value of the company's assets may be less than the stipulated

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[12] *Federal Water Service Corp.*, 8 S. E. C. 893 (1941), remanded on another point, *S. E. C.* v. *Chenery Corp.*, 318 U. S. 80; *International Utilities Corp.*, Holding Company Act Releases Nos. 4896, 4992 (1944), enforcement proceedings pending in United States District Court for the Northern District of New York.

[13] *Community Power and Light Co.*, 6 S. E. C. 182 (1939), plan enforced, 33 F. Supp. 901 (S. D. N. Y., 1940); *Puget Sound Power & Light Co.*, Holding Company Act Release No. 4255 (1943); *Southern Colorado Power Co.*, Holding Company Act Release No. 4501 (1943); *Virginia Public Service Co.*, Holding Company Act Release No. 4618 (1943). The Commission's orders in the *Puget Sound* and *Southern Colorado* cases have been enforced (without opinion) in the United States District Courts for Massachusetts and Colorado, respectively. An appeal is pending in the *Southern Colorado* case.

Mimeographed copies of the Commission opinions not yet reported are being filed with the Clerk.

liquidation preference of the preferred stock. Such a participation allowed for the common stock has, of course, resulted in according the preferred stock less than 100% interest in the corporation. In each of these cases, as in this case, Commissioner Healy has dissented, and petitioner relies on a number of these dissenting opinions. Petitioner's theory as to the proper standard applicable in all types of such reorganization is that preferred stockholders cannot be fully compensated by receipt of less than 100% of the new securities unless the present value of the assets exceeds the liquidation preference of the preferred stock, including arrears of cumulative dividends. A necessary consequence of that view is that where the assets are found to be less than the liquidation preference, the common stock must be wiped out, notwithstanding a finding that there is a reasonable prospect of common stockholders participating in future income under the existing security structure."

" In addition to his disagreement on the law, Commissioner Healy also disagreed, in this and in previous cases, with the majority's finding that the junior stock in question would have had a reasonable expectation of participating in future dividends in the absence of a reorganization. The Commission opinions referred to are set forth *supra*, footnotes 12 and 13. In the first case involving this problem, *Community Power and Light Co.*, 6 S. E. C. 182 (1939), Commissioner Healy concurred in the result without opinion. The Commission's order in that case was enforced in the District Court for the Southern District of New York.

In the present case the preferred and common stockholders of Power were allocated new securities which the Commission found to be the equitable equivalent of their existing interests in the same enterprise. Nevertheless, since the readjustment took the form of a "liquidation" of the corporate entity in which they held stock, this novel feature of the case is used to buttress petitioner's argument. However, the petition for certiorari, like petitioner's argument in the court below, goes beyond this aspect of the case and challenges the Commission's interpretation of the standard in all types of corporate simplification plans. The position of the majority of the Commission, approved by the courts below, is that the formal mechanics by which a Section 11 corporate readjustment is accomplished should not affect the substantive interpretation to be given to the "fair and equitable" standard.

Although the decision of the circuit court of appeals was correct, we submit, and is in accord with the uniform holdings of all courts which have considered the question,[15] we believe that there is a

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Community Power and Light Co., 33 F. Supp. 901 (S. D. N. Y. 1940). Commissioner Healy did not participate in *International Utilities Corp.*, Holding Company Act Releases Nos. 4896, 4992 (1944).

[15] *Community Power and Light Co.*, 33 F. Supp. 901 (S. D. N. Y. 1940); *Puget Sound Power & Light Co.*, D. Mass. June 10, 1943 (no opinion); *Southern Colorado Power Co.*, D. Colo. Jan. 19, 1944 (no opinion; appeal pending in C. C. A. 10).

public interest in a determination by this Court which would lay at rest any questions which may remain as to the correctness of the result. The issue is presented in more than twenty proceedings before the Commission and is likely to arise in numerous other proceedings necessary to the administration of the Act. In addition, the issue is pending in one case now on appeal in a circuit court of appeals.[16]

CONCLUSION

The foregoing exposition of the factual and legal basis of the Commission's decision in this case demonstrates, we believe, the correctness of that decision and of the affirmance thereof by the courts below. We understand that the company will oppose certiorari because of its desire to go forward with the consummation of its plan.

In unsupervised voluntary reorganizations which occasionally reach the courts under attack for such gross unfairness as amounts to constructive fraud (*Hottenstein* v. *York Ice Machinery Corp.*, 136 F. (2d) 944 (C. C A 3, 1943)), the common stock ordinarily demands and receives a much larger participation than has been permitted in the Commission's cases. Commentators have approved the Commission's trend of decision as reaching a more equitable result than is customarily reached in the unsupervised cases. See: Dodd, *The Relative Rights of Preferred and Common Shareholders in Recapitalization Plans under the Holding Company Act* (1944), 57 Harv. L. Rev. 295; Dodd, *Fair and Equitable Recapitalizations* (1942), 55 Harv. L. Rev. 780; Latty, *Fairness—The Focal Point in Preferred Stock Arrearage Elimination* (1942), 29 Va. L. Rev. 1.

[16] See *Southern Colorado Power Co.* case, *supra*, note 15.

We should regret the delay that further review would cause to the carrying out of the company's program. Nevertheless, we believe that the importance of the question presented in the administration of the Act warrants review by this Court.

Respectfully submitted.

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MAY 1944.

APPENDIX

The pertinent provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803 (15 U. S. C. §§ 79, *et seq.*), are as follows:

SECTION 11 (b) (2):

> (b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:
>
> * * * * *
>
> (2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the pur-

pose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

* * * * *

SECTION 11 (d):

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the

first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

SECTION 11 (e):

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appro-

priate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

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No. 81

In the Supreme Court of the United States

OCTOBER TERM, 1944

OTIS & CO., PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

OPINIONS BELOW

The findings and opinion of the Securities and Exchange Commission (R. 2, 77), not yet officially reported, are set forth in the Commission's Holding Company Act Release No. 4215. The opinion of the United States District Court for the District of Delaware (R. 82) is reported in 51 F. Supp. 217. The opinion of the United States Circuit Court of Appeals for the Third Circuit (R. 123) is reported in 142 F. (2d) 411.

JURISDICTION

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered April 20, 1944 (R. 142). The petition for a writ of certiorari was filed on May 11, 1944, and granted June 12, 1944 (R. 144). The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925, the provisions of which are made applicable by Section 25 of the Public Utility Holding Company Act of 1935 (the "Act"; 49 Stat. 803, 15 U. S. C. § 79a et seq.).

STATUTE INVOLVED

The applicable provisions of the Act are set forth in Appendix A, *infra*, pp. 80–91. The substance of the relevant statutory provisions is as follows:

Under Section 11 (b) (2) of the Act, it is the duty of the Commission to require all registered holding companies and their subsidiaries to "take such steps as the Commission shall find necessary" to simplify the structures of their holding company systems and to correct the distribution of voting power. Included in the section is a specific instance of undue complications the correction of which is mandatory; namely, that which occurs where there exist in a holding company system more than two tiers of holding companies. This requirement of Section 11 (b) (2), applicable in this case, is sometimes referred to

as the "great-grandfather" provision. Orders under Section 11 (b) are reviewable in a circuit court of appeals and are to be complied with within one year from the date of the order unless the time for compliance is extended for cause.

To enable the Commission to *compel* compliance with its orders issued under Section 11 (b), the Commission is authorized by Section 11 (d) of the Act to resort to the district courts of the United States for enforcement thereof; and the courts are empowered, *inter alia,* to dispose of the corporate assets "in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing."

Of immediate application here is Section 11 (e) relating to *voluntary* compliance. Section 11 (e) permits a company subject to Section 11 (b) to "submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling" the company to comply with Section 11 (b). The Commission, after notice and opportunity for hearing, is authorized to consider whether the plan is "necessary to effectuate the provisions of subsection (b) *and fair and equitable to the persons affected by such plan,*" and if the Commission so finds, to make an order approving the plan. Thereafter, the Commission

is empowered, at the request of the company, to apply to a district court "to enforce and carry out the terms and provisions of such plan." The court, after notice and opportunity for hearing, is authorized to "approve such plan as *fair and equitable* and as appropriate to effectuate the provisions of section 11"[1] and is vested with jurisdiction to enforce the plan so approved.

PRELIMINARY STATEMENT OF QUESTIONS PRESENTED

The ultimate issue in this case is whether the Commission and the district court were warranted in approving as "fair and equitable," within the meaning of Section 11 (e) of the Act, a plan of compliance with Section 11 (b) submitted by The United Light and Power Company (hereinafter referred to as Power). The plan affects only the interests of Power's preferred and common stockholders, after full provision for creditors' claims, and accords both classes of stockholders continuing interests in the same underlying enterprise in the form of common stock of a subsidiary holding company one step "nearer to the rails." The new stock was allocated among Power's preferred and common stockholders respectively in the proportion of approximately 95–5%, which was in accordance with the Commission's appraisal of their respective interests in the enterprise as they exist apart from the requirements of Section 11.

[1] No question was raised in the present case as to the findings that the plan was necessary and was appropriate to effectuate the provisions of Section 11.

This appraisal took into account the entire bundle of rights affected. While the Commission observed that the present value of Power's assets is less than the charter liquidation preference of the preferred, the charter gives preferred stockholders no right to mature their liquidation preference, and, accordingly, the common stockholders are entitled (apart from the Act) to continue in the enterprise with what the Commission found to be a reasonable prospect of participating in future earnings after the eventual discharge of preferred dividend arrears. The Commission interpreted Section 11 (e) as not intended to give a windfall to any class of investors at the expense of another, and therefore as requiring it to treat the liquidation preference of the preferred stock as unmatured for the purpose of determining what allocation of Railways' stock would represent the "equitable equivalent of the rights surrendered" by each class of stock affected. On this theory it concluded that an allocation of 95% of Railways' stock to Power's preferred stockholders constituted full recognition of their "absolute priority." This is in accordance with standards of fairness which the Commission had consistently applied under Section 11 (e) to corporate readjustments where elimination of the corporate entity was not involved. The only new circumstance involved in the present case is that instead of recapitalizing the holding company or merging it with a subsidiary, as was done in prior cases,

the readjustment here substitutes a subsidiary for the parent company by distributing the common stock of the subsidiary to the stockholders of the parent in "liquidation" of the latter.

Commissioner Healy has consistently dissented from the views of a majority of the Commission in the various decisions which have applied this test. Petitioner, relying on these dissents, argues that either the readjustment process itself, or the statutory necessity for reorganization, must be treated as maturing the liquidation preference of the preferred stock and that, therefore, the liquidation preference of the preferred stock becomes the sole measure of its right to participate in a plan under Section 11 (e). In other words, petitioner insists that the legitimate investment value represented by the common stockholders' interest in future earnings must be sacrificed to the preferred stock as a direct result of the operation of Section 11. Additional strength for this contention is sought to be derived here from the circumstance that in this particular case a prior order of the Commission required the liquidation of Power as a separate corporate entity in the holding company system and, in conformity with that order, the plan in question takes the form of a plan of liquidation.

Two questions are therefore presented:

(1) Is the Commission required to treat the liquidation preference as the sole and controlling

measure of preferred stockholders' rights in any type of readjustment of stockholders' rights submitted under Section 11 (e) of the Act?

(2) Assuming that the standard applied by the Commission in this case is one which would have been properly applicable in the event of a recapitalization or merger, does the circumstance that the readjustment takes the form of a "liquidation" of Power require a different standard in which charter liquidation preferences are the sole measure of the stockholders' rights?

STATEMENT

(A) PROCEEDINGS BEFORE THE COMMISSION

Power is a registered holding company organized in 1923 under the laws of Maryland. At December 6, 1940, the date of the commencement of the Commission's proceedings with respect to Power, there were fifty-two companies, including seven registered holding companies, in the Power holding company system. Power, at the top, owned directly the securities of a number of its utility operating subsidiaries, but most of the operating companies were controlled indirectly through The United Light and Railways Company (hereinafter referred to as Railways), a principal subholding company, which in turn controlled its operating subsidiaries through additional intermediate holding companies.

Earlier in the proceeding, on March 20, 1941, the Commission ordered Power to liquidate and dissolve in order to comply with the requirements of Section 11 (b) (2) and particularly the second sentence thereof, commonly known as the "great-grandfather" provision (R. 120). No review was sought of that order.

Thereafter, the Commission approved various applications filed by Power for approval of steps

necessary to carry out the required liquidation. These included provision for all of Power's funded debt. As the final step in its program of liquidation, Power submitted to the Commission in Application No. 14 a plan for the retirement of its remaining debt (consisting of $1,500,000 of bank notes), for the transfer of miscellaneous assets as a capital contribution to Railways and for the distribution of Power's remaining asset, the common stock of Railways, to the holders of its preferred and common stocks on the basis of an allocation of 91.2% of such common stock to Power's preferred stockholders and 8.8% to its common stockholders.[2]

Evidence was taken on this plan, and thereafter the Commission issued its opinion disapproving the company's proposed allocation as being too generous to the common stock but finding that an allocation of approximately 5% to the common stock would be fair (R. 2). In accordance with that opinion, the plan was modified to provide for the allocation of 94.52% and 5.48% of Railways' common stock to Power's preferred and common stockholders, respec-

[2] Power's Class A and Class B common stock have identical rights except that voting rights are vested exclusively in the Class B common. To simplify analysis we refer to the combined interests of both classes under the generic term, "common stock," as did the Commission and the courts below.

tively [5] (R. 98). With this modification the plan was approved by the Commission as fair and equitable (R. 77, 78). Subsequent references herein to the plan mean the plan as so modified.

(B) PROCEEDINGS BELOW

Pursuant to Section 11 (e) of the Act, the Commission, at the request of Power, applied to the United States District Court for the District of Delaware to enforce the plan (R. 82). The district court, after notice and hearing (R. 121), approved the plan by judgment entered August 4, 1943 (R. 95). On appeal by Otis & Co., a preferred stockholder which had appeared in opposition to the fairness of the plan in the district court, the circuit court of appeals unanimously affirmed the judgment of the district court (R. 123, 142).[6]

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[5] The specific percentages reflect an allotment of five shares of Railways' common for each share of Power's preferred and one share of Railways' common for each 20 shares of Power's common. There was, of course, no pretense of decimal accuracy in the allocation.

[6] Power's brief in this Court (p. 6) emphasizes petitioner's failure to seek direct review in a circuit court of appeals (under Section 24 (a) of the Act) of the Commission's order approving the plan. The Commission, however, has taken the position that an order approving a plan to be consummated only after hearing and approval of the plan by a district court is not a reviewable order within the scope of Section 24 (a). See *Okin* v. *S. E. C.* (C. C. A. 2d), decided October 24, 1944.

(C) THE FACTUAL BASIS OF THE COMMISSION'S CONCLUSION THAT THE PLAN IS "FAIR AND EQUITABLE"

We do not conceive that there remains any issue before this Court as to the facts found by the majority of the Commission, inasmuch as the petitioner, in appealing from the district court's order, did not bring up the factual record to the circuit court of appeals; nor is it here. Moreover, petitioner does not challenge the amount of the allocation to common stockholders once it be determined that they are entitled to any participation under the plan. We nevertheless set forth below an analysis of the majority's interpretation of the facts for the light it throws upon the practical operation of the standard of fairness applied in this case.

The basic problem before the Commission was what distribution of the common stock of Railways between Power's two classes of stockholders would be fair and equitable. One factor considered by the Commission was that the preferred had a preferential right by charter to receive $100 per share plus $64.50 accumulated dividends (as of December 31, 1942) on "voluntary or involuntary" dissolution or liquidation, or an aggregate of $98,700,000, including dividend arrearages, on the outstanding 600,000 shares, before any payment might be made to the common (R. 9). All members of the Commission con-

cluded that the value of Railways' common stock was less than the liquidation preference of Power's preferred stock, and that if the sole basis of allocation was the charter liquidation preference, then the common stockholders could take nothing (R. 9–11, 44).

The factual analysis used by the majority of the Commission went beyond this point, however. The majority considered the past earnings of Power and Railways, on both corporate and consolidated bases with adjustments for certain nonrecurring items, in order to arrive at an estimate of the future earning power of Railways' common stock. Power's corporate income since 1932 had been less than the annual preferred dividend requirement of $3,600,000, but the consolidated net income had fluctuated widely, and over the period of 1929–41 had produced a net balance in excess of the current requirements of Power's preferred stock of over $18,000,000 (R. 19). The bulk of the consolidated earnings had not, however, been taken up into Railways or Power, and no dividends had been paid on Power's preferred or common stocks since 1932. The $38,700,000 of accumulated arrears of preferred dividends were a non-interest-bearing charge while the $45,000,000 (approximately) of system earnings retained in the business during the 1929–1941 period (R. 19) had been used to strengthen the subsidiary companies of the system. Reflecting in

part better business conditions and in part improvement in earning capacity as a result of this retention of earnings, consolidated earnings applicable to the common stock of Railways for the period 1937–42 (adjusted for certain nonrecurring expenditures) had approximated $6,185,000 as an annual average. Consolidated income for the latest year of this period, 1942 (nine months actual, three months estimated), amounted to approximately $7,100,000. (R. 18–26.)

From the foregoing and the management's testimony as to estimated future earnings, the majority of the Commission concluded that the figure of approximately $6,185,000 representing the 1937–42 average of consolidated earnings might be used as an estimate of future earnings attributable to Railways' common stock, for the purpose of determining the existing rights of Power's preferred and common stocks in the enterprise (R. 24). This figure was considered, however, to be a "very liberal assumption" and was to be discounted accordingly (R. 24–25).[5] On this basis, and assuming that all consolidated net earnings might be applied to the payment of current and accumulated preferred dividends (again, an assumption which the Commission discounted as over-liberal),[6] it would take approximately 15

[5] As explained below (note 8), implicit in the Commission's decision is the application to this estimate of a very high discount rate in view of the high risk factor applicable to such a liberal estimate.

[6] See note 7, *infra*.

years to pay off Power's preferred dividend arrearages (R. 24).

The majority of the Commission emphasized the remote character of the common stockholders' interest and for that reason disapproved the company's proposal to allocate approximately 9% of the common stock of Railways to the common stockholders of Power (R. 24–25). Nevertheless, it was concluded that, absent liquidation or reorganization to comply with Section 11, there was a reasonable possibility that, on the basis of its existing capital structure, Power would ultimately pay off the preferred dividend arrearages and place the common stock on a dividend-paying footing. The possibility was deemed sufficiently substantial to justify an allocation to the common stock, although less than the amount which had been proposed. With respect to the size of the allocation, the majority held that a participation of approximately 5%, "while representing the maximum, would not exceed the permissible limits of fairness" (R. 25–26).

The Commission regarded this determination as "of necessity one of over-all judgment and not susceptible of mathematical demonstration" (R. 25). Without desiring to create an illusion of greater certainty than is possible in dealing with the unknown future, we believe that certain mathematical computations may help to illustrate the relationship between the earnings figures used

by the Commission and its over-all judgment that an allocation in the ratio of approximately 95% to Power's preferred stock and 5% to the common stock would be fair.

If we project the earnings figures found by the Commission forward some 15 years, the preferred dividend arrearages would be paid, whereupon the preferred stock under their existing contract rights would be limited to an annual dividend of $3,600,000, and 100% of all the additional earnings would be applicable to the common. Under the Commission's suggestion of a 5% participation for the common stock of Power, and using the $6,185,000 figure for estimated earnings, the common stockholders would surrender their future 100% interest in $2,585,000 of excess annual earnings to begin in 15 years, in exchange for a 5% interest in the entire $6,185,000 estimated annual earnings, or $309,250, beginning at once and continuing indefinitely.[7] In turn, the pre-

[7] This analysis concededly involves some over-simplification. We are speaking of estimated consolidated earnings which would not as a practical matter be entirely distributed in dividends. To the extent that such earnings would be retained in the business, the amount immediately payable would necessarily be reduced, thereby delaying progress in discharging the dividend arrears. On the other hand, retention of earnings without the necessity of paying interest on the unpaid preferred dividends might result in increasing the aggregate earnings distributable over the 15-year period. How much these factors would ultimately affect the amount available for the common stock after the dividend arrears should be paid, and the time required to pay off arrears,

ferred stockholders would surrender approximately 5% of their exclusive interest in all earnings during the 15-year period and in the first $3,600,000 of income thereafter. In addition to retaining the remaining 95% of their present interest in these earnings, the preferred stockholders receive a new right in perpetuity to 95% of any earnings in excess of their existing preferential claim, which excess on the basis of the above figures would begin to be available at the expiration of 15 years and amount to $2,456,000 per annum. Expressed in terms of a per share basis preferred stockholders give up a present interest in earnings at the rate of approximately $10.31 per share for 15 years and $6 per share thereafter, in return for earnings of $9.79 applicable to the new shares in perpetuity. Implicit in the conclusion that these new respective interests in earnings, allocated to preferred and common stockholders, are the fair equivalents of what they are giving up, is an application of a discount rate of approximately 15% to the $6,185,000 estimate of future earnings.[8]

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would depend upon the amount of additional income received from the earnings retained in the business.

[8] The difference between what the common stockholders would surrender after elimination of arrears and what they would receive under the Commission's suggested allocation (a ratio of about 8.4 to 1) indicates how the Commission appraised the advantage to the common stock of the elimination of the 15-year delay, the $3,600,000 annual preference of the preferred stock, and the risk that distributable earnings

In the following charts, the participation of the common stock in Railways' earnings prospects is represented by the shaded portion; chart I represents the present situation, and chart II represents the effect of the plan.

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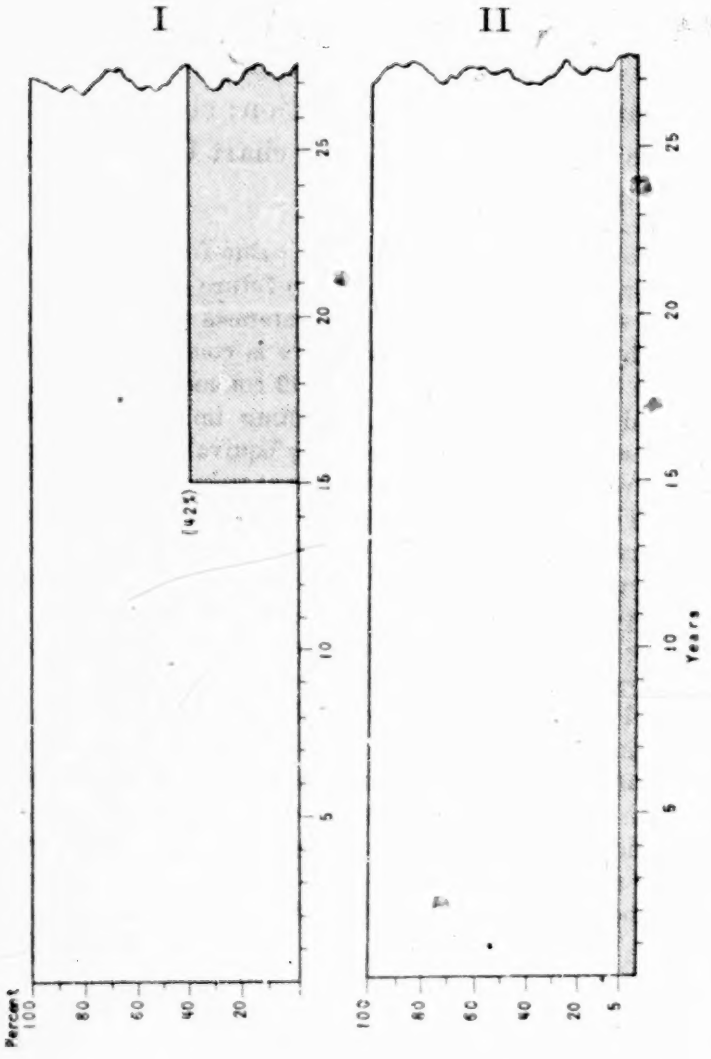
might prove less than the estimate. But for the inherent risk factor, the difference between the future interests which would be surrendered and the new interests presently to be received by the common stockholders is comparable to the difference between an annuity of $8.40 commencing 15 years hence and an annuity of $1 beginning immediately. To make these annuities mathematically equivalent, the larger would have to be discounted to present value at the rate of 15.2%. This very high discount rate measures the risk factor involved in the assumption by the majority of the Commission that Power's common stock had a reasonable prospect of receiving an estimated $2,585,000 annually beginning 15 years in the future, and offsets the "very liberal" character of the estimate of consolidated earnings.

Under Power's original plan of allotting 8.8% to the common stock, the common would have been given a present annuity of $544,280 in lieu of the future annuity of $2,585,000. This would have indicated a discount rate of 11%, a ratio which justifies the conclusion implicit in the Commission's rejection of Power's original plan that the common was being allotted too much in view of the risks involved.



In justifying its assumption that it had adequately discounted the risks involved in its estimate of earnings, the Commission pointed out that the earnings of a top holding company in a pyramided system are subject to wide fluctua-

tions.[9] An unexpected increase of only a few percent in operating company earnings will be magnified into a very great improvement at the holding company level. Accordingly, the Commission found it appropriate to consider the possibility that future earnings might actually exceed even its "very liberal" estimates, as well as the risk that they might be substantially less.

Summarizing these considerations, the Commission stated (R. 25–26):

> This conclusion takes into consideration the fact that, to the extent its earnings should perchance exceed those estimated, the common stock, in exchange for an allocation of approximately 5% would be giving up its claim to 95% of any possible excess over the amount necessary to sat-

[9] The leverage position of Power's security holders is illustrated by the following table in the record before the Commission and before the district court showing fluctuations in consolidated earnings available for the senior securities of Power for the years ended December 31, 1931–1939:

Year ended December 31—	Percent of change over preceding year		
	Subsidiary income before fixed charges	Income available for Power's fixed charges	Net income applicable to Power's preferred stock
1931	−8	−19	−25
1932	−14	−35	−47
1933	−15	−43	−64
1934	−5	−13	−35
1935	+7	+40	+144
1936	+8	+41	+87
1937	+3	+9	+15
1938	−10	−28	−40
1939	+6	+27	+49

isfy the dividend preferences of the preferred. In other words, as the participation of the common stock approaches zero it is giving up, in exchange therefor and for the benefit of the preferred stock, nearly 100% of its chance of participating in any future earnings in excess of the existing preferences of the preferred. On the other hand, if earnings do not equal such preferences, the preferred stock gives up but approximately 5% of the earnings actually realized.*

Under the circumstances here present, we are unwilling to permit the complete elimination of the common stock. Our conclusion in this regard is reinforced by reason of our belief that the whole future program of corporate simplification and geographic integration of the system, as in the case of the present step in such program, will result in an improvement of the investment position of both the preferred and common stock. That improvement, we believe, should be shared by the common as well as by the preferred, and the process of securing such improvement in compli-

* In considering the possible margin of error inherent in any attempt to forecast future earnings, allowance must be made for the fact that we are dealing with a top company in a pyramided structure. As a result of "leverage" any fluctuations in underlying earnings are greatly magnified in their impact upon earnings available for securities of the top holding company.

ance with the Act should not be permitted to destroy existing investment values.

Accordingly, the majority held that the allocation of 5% to Power's common stock was a fair allocation taking account of all the considerations involved. Commissioner Healy's dissenting opinion (R. 37), which, as the court below noted (R. 126; and see Pet. Br., p. 28), has been in substance adopted by the petitioner as its argument, sharply disagreed with this conclusion.

The dissent rests primarily upon the disagreement with the majority's interpretation of the "fair and equitable" standard of Section 11 (e), which is the basis for the petitioner's argument here. In addition, there was a substantial difference in the dissenting Commissioner's interpretation of the facts. While this factual difference may involve some difference in judgment as to prospective future income attributable to the common stock of Railways, it would seem that even this apparent factual difference is primarily a reflection of a different conception of the applicable standard of law.[10] In any event, as has been stated, we do not regard these factual differences as now in issue.

[10] As stated above, the majority opinion expressly describes the estimates used by it as "liberal." The dissent merely emphasizes the basis for assuming that future earnings may actually be less than the majority assumes. However, the majority's use of a concededly liberal estimate is compensated for by the high discount rate which we have indicated is implicit in the conclusion that common stockholders' par-

SUMMARY OF THE ARGUMENT

Section 11 was intended to bring about the geographic integration and simplification of holding company systems without destruction of any legitimate investment interest in the existing structures, and the "fair and equitable" standard

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ticipation should be limited to approximately 5%. See note 8, *supra*. This applies both to Commmissioner Healy's criticism that the adjustment of past earnings for nonrecurrent items is based upon too liberal assumptions, and also to his criticism that the majority opinion related future estimates of corporate earnings to the past record of consolidated earnings. The dissenting opinion emphasized the fact that in prior years the corporate earnings have been substantially less than consolidated earnings. However, the past record of the relationship between corporate and consolidated earnings is not necessarily the significant index for the future. Completion of the statutory simplification program will remove dividend blocks which have prevented the passing up of dividends of Railways' subsidiaries in the past and will restore managerial incentive so to do. Furthermore, any dividends not paid up will, as invested funds, produce earnings, and thereby increase system earnings.

As stated in the concurring opinion of Commissioner Burke (R. 36–37):

"Under these circumstances, as the participation of the common approaches zero, we are warranted in considering increasingly liberal assumption in favor of the possibility that earnings may substantially exceed what may be characterized as 'reasonably foreseeable.' In other words, the possible (though unlikely) rather than the probable range of earnings may be taken into account * * * —whereas allotment of a more substantial participation would necessitate a more conservative appraisal. In view of these considerations I am unable to say that an allocation around 5% would be unfair."

The majority of the Commission expressed a similar thought in the portion of the opinion quoted in the text, pp. 19–21, *supra*.

must be applied with this end in mind. In this case we are dealing with the interest of a common stock which has a somewhat remote but nevertheless appreciable future interest in the earnings of the enterprise, and a preferred stock having a preferential but limited claim on earnings, which income preference is insufficient to absorb all of the estimated future income. While the preferred stock has a contractual right, *in the event of liquidation*, to a preferential claim on assets in an amount exceeding the value of Power's assets, it has no contractual right *to require* liquidation or other reorganization.[11] On the contrary, the common stock—apart from Section 11—has a contractual right to continue in the enterprise without interference and with a view to participating in earnings after satisfaction of the arrears of cumulative preferred dividends.

It is in this setting that the fair and equitable standard must be applied. Looking at the operation of the statute as a whole—the requirement for reorganization, plus the plan of compliance—it seems clear that preferred and common stockholders are receiving the equitable equivalent of their entire respective bundles of rights surrendered. Petitioner argues that Section 11, or the prior order of the Commission, destroyed the

[11] Nor does it appear that there are equitable grounds which would entitle preferred stockholders to apply for a receiver to liquidate Power. Cf. *S. E. C.* v. *Fiscal Fund, Inc.*, 48 F. Supp. 712 (D. Del. 1943).

common stockholders' right to "keep going," and matured the otherwise inchoate liquidation preference of the preferred stock, and did so without possibility of compensation to the common stockholders. On that basis petitioner claims for the preferred stock the entire value of the enterprise. But Congress, in requiring the simplification of holding company systems, coupled with that requirement a provision for fair and equitable reorganization plans. Since the very purpose of doing so was to prevent the destruction of any legitimate investment values inherent in the existing structures, the Commission was warranted in measuring the treatment of preferred and common stockholders in the plan in the light of their existing status—apart from the operation of the statute. It was not required to treat the statute as adding new values to the preferred stock at the expense of the common—and then to treat this new status as the point of departure from which to measure the fairness of the plan.

Since the standard applied by the Commission fully recognizes the "absolute priorities" of Power's preferred stockholders in their relevant context, it is entirely consistent with the bankruptcy reorganization and equity receivership precedents dealing with matured claims.

It is immaterial that the instant plan happens to involve a liquidation, rather than employs some other procedural device which would not come

within the letter of the preferred stockholders' charter liquidation preference. The essence of the reorganization process is the remolding of contract rights and the substitution therefor of equitable equivalents. Here "liquidation" of Power as a corporate entity happens to be the most convenient procedural mechanism to accomplish the necessary reorganization. It is sufficient that both classes of Power's stock receive continuing interests in the same underlying business enterprise in proportion to their existing stakes in that enterprise. The "fair and equitable" standard must be applied in the light of what the plan does to the security holders affected, rather than in such a way as to require different relative participations depending on the procedural mechanics of the reorganization.

ARGUMENT

I

THE "FAIR AND EQUITABLE" STANDARD OF SECTION 11 (E) REQUIRED THE COMMISSION TO MEASURE THE RESPECTIVE PARTICIPATIONS OF POWER'S PREFERRED AND COMMON STOCKS IN THE REORGANIZED ENTERPRISE IN THE LIGHT OF THEIR RESPECTIVE BUNDLES OF RIGHTS AND NOT SOLELY ON THE BASIS OF THEIR LIQUIDATION PREFERENCES

1. Relation of the "fair and equitable" standard to the statutory scheme

(a) Conditions which Section 11 was designed to meet.

As expressly stated in Section 1 (c), the Act was passed "to meet the problems and eliminate the evils" enumerated in Section 1 (b):

> and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

Thus, the integration and simplification provisions of Section 11 were declared to be the very heart of the Act.[12] Reference to the condition of the holding company industry at the time of the passage of the Act will readily indicate why this was so.[13]

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[12] The Senate Committee Report stated (S. Rep. 621, 74th Cong., 1st Sess., p. 11):

"As has been pointed out above, the purpose of section 11 is simply to provide a mechanism to create conditions under which effective Federal and State regulation will be possible. It is therefore the very heart of the title, the section most essential to the accomplishment of the purposes set forth in the President's message."

[13] That condition had been the subject of the voluminous Federal Trade Commission Report, *Utility Corporations*, 70th Cong., 1st Sess., Senate Document 92. This report and that of a House Committee are referred to in Section 1 (b) of the Act. A summary of the Federal Trade Commission findings appears as No. 72-A of its Report (hereinafter cited as "Utility Corporations, No. 72-A"). See also Barnes, *The Economics of Public Utility Regulation* (1942), pp. 61-148, 671.

The period of the late 20's and early 30's had been characterized by a mushroom growth of holding companies, and in consequence at the end of this period the typical holding company system controlled a group of scattered public utility companies with no operating relationship to each other, and had a security structure of great complexity. In this expansion, several layers of holding companies were "pyramided" on top of the ultimate revenue-producing operating subsidiaries and there were typically two or more different classes of securities outstanding at each level in the pyramid. Promoters' hopes had been predicated on the hypothesis that earnings at each level in the pyramid would exceed the cost of "senior money" as represented by the interest charges payable on publicly held debt securities and the dividend requirements of publicly held preferred stock. Thus, because of the "leverage" aspects of the security structure, expectations had been aroused of receiving an ever increasing rate of return on the ultimate equity security at each level of the pyramid.[14] Under boom-time psychology this was frequently regarded as a desirable characteristic insofar as the holders of equity securities were concerned, and the prices of such securities rose to fan-

[14] For further explanation of the "pyramiding" aspect of holding company security structures: see *Utility Corporations*, No. 72–A, pp. 157–166, 858–859, and see Barnes, *The Economics of Public Utility Regulation*, pp. 73–84.

tastic levels.[15] The risk factor was overlooked. Purchasers of holding company bonds and preferred stocks which, because of their limited claim on earnings, obtained little of the possible advantages of such leverage, nevertheless bore the bulk of the risk because they had contributed most of the capital at stake. The leverage factor also tended to magnify the consequence to all holding company security holders of misleading accounting practices of the period.[16]

With the advent of the depression the earnings of the operating companies, particularly the electric utility subsidiaries, held up relatively well.[17] Nevertheless, there was a spectacular collapse in market prices of holding company

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[15] Hearings before Committee on Interstate and Foreign Commerce on H. R. 5423, 74th Cong., 1st Sess. (1935), at p. 2090.

[16] "It has been found that it is quite a common practice among holding companies to overstate earnings and surplus by recording unrealized earnings. The usual ways of doing this are through counting as income intercompany profits, undistributed earnings of subsidiaries, and the erroneous recording of stock dividends, stock rights, etc., received. The creation of surplus by the inflation or write-up of assets has been very general.

"With respect to operating companies, the usual methods of overstating surplus are through inadequate provisions for depreciation, revaluations of fixed assets, and the improper capitalization of expenses." *Utility Corporations*, No. 72–A, pp. 514–515. See also pp. 528–533, 868–870.

[17] As a whole, the electric utility industry had greater gross revenues in 1936 than it did in 1929. See "The Electric Light and Power Industry in the United States," Edison Electric Institute Statistical Bulletin No. 9, 1941, at p. 39.

securities of all classes. It was then for the first time brought home to the average investor in the common stocks of holding companies that leverage operates both ways. Many holders of holding company bonds and preferred stocks in turn realized for the first time that what they had really purchased was in the nature of a limited dividend common stock.[18]

Some of the major holding company systems, of course, went into bankruptcy and to the extent that this was so, there was the possibility of reorganization in the bankruptcy proceedings. However, in many other instances the immediate cause of the financial difficulty was not primarily excessive amounts of debt securities but excessive amounts of preferred stock at various levels in the financial pyramid. There were widespread failures of such holding companies to maintain dividend payments on their preferred stocks.[19]

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[18] See testimony of Commissioner Healy in Hearings Before House Committee on Interstate and Foreign Commerce on H. R. 5423, 74th Cong., 1st Sess. (1935), at p. 212.

"Commissioner HEALY. That is right. That is, you have the spectacle of people buying preferred stock in a holding company saying that they would not touch a common stock with a 10-foot pole, and when they look into the portfolio of the holding company and its assets, they see that they are common stocks, and they have bought common stocks without knowing it. And, the same thing is true of bonds. They rest upon those stocks."

[19] As the Commission has stated in its Ninth Annual Report to the Congress (at p. 25):

"As of December 31, 1938, holding companies registered under the Holding Company Act had outstanding $2,450,-

Arrearages were caused in part by an actual insufficiency of current income of the system and in part because it became impossible to bring up more than a small proportion of the consolidated income to the top holding companies. Inability to distribute income was due both to recognized impairments of capital, which created blocks to the upward flow of income otherwise available, and also to the difficulty of selling additional securities for plant additions which were needed by the operating companies to meet a continued increase in demand for electricity. Where new securities could not be sold the operating companies were compelled to withhold dividends and reinvest their earnings in capital additions.

With respect to this problem of raising new capital it should be noted that the holding company securities had lost their glamour, and had become difficult to sell. Moreover, when it came to considering holding company legislation, even the holding company spokesmen did not seriously question the advisability of regulation which might prevent future issues of the types of holding company bonds and preferred stocks that had

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000,000 of preferred stocks. Of this total, more than half, or $1,400,000,000, was in arrears in dividends, the total accumulated arrearages being some $363,000,000. Even many utility operating companies were so overcapitalized that they could not meet their preferred dividends. Of $1,750,000,000 of preferred stocks of operating companies, approximately $500,000,000 were in default, the arrearages aggregating $148,000,000."

been so widely distributed in the promotional era.[20] In fact Sections 7 (c) and (d) of the Holding Company Act provide that only under narrowly defined exceptions may holding companies issue anything but common stocks for new capital. The fantastic financial superstructure which had been imposed upon an operating industry which was recognized to be of vital public importance and, as well, to be capable of affording a sound medium for investment, thus pointed to the need of a sweeping reorganization of the industry.

(b) Recommendations of National Power Policy Committee

The general outlines for the holding company legislation took shape in a report of the National Power Policy Committee on Public Utility Holding Companies, which was transmitted by the

[20] Indeed, the only qualification which the holding company spokesmen made with respect to the regulation of the types of securities which should be permitted to be issued in the future, was that the Commission should have more discretion in the matter than was envisaged by the proponents of the legislation. See statement of Wendell L. Willkie (then President, Commonwealth & Southern Corporation), Hearings Before the Committee on Interstate Commerce, United States Senate, 74th Cong., 1st Sess., on S. 1725, pp. 598, 613–614; statement of James F. Fogarty (then President, North American Co.), Hearings Before the Committee on Interstate and Foreign Commerce, House of Representatives, 74th Cong., 1st Sess., on H. R. 5423, Pt. II, p. 993; statement of Henry L. Harriman (former President, United States Chamber of Commerce, associated with New England Power Association), *ibid.*, Pt. II, p. 1559–1560.

President to the Congress in his message of March 12, 1935, and which served as a blueprint for the drafting of holding-company bills.[21] We quote below the recommendations of that Committee insofar as pertinent to Section 11:

> We therefore recommend Federal legislation regarding public-utility holding companies. Such legislation should eradicate disclosed abuses, prevent the use of the holding company and affiliated interests to obstruct State regulation of operating companies, and make possible the elimination of the holding company where it serves no demonstrably useful and necessary purpose, without undue dislocation of investment or the loss of operating economies which flow from economically and geographically integrated public-utility systems.
>
> 1. The ultimate purpose of the legislation should be the practical elimination within a reasonable time of the holding company where it serves no demonstrably useful and necessary purpose. But the amount of reorganization, transfers of assets, and distributions in dissolution required for the dismantling of our huge holding-company systems is so great that the task of elimination cannot be accomplished in a year or two without possibly too great sacrifice of apparent values. Furthermore, it seems administratively advis-

[21] See S. Rep. No. 621, 74th Cong., 1st Sess., pp. 55–60. For the convenience of this Court we have reprinted this report as Appendix B to this brief.

able that every opportunity be offered the owners of holding-company securities to work out their own processes of dismantling. That opportunity should, of course, be vigilantly guarded to protect the average investor from the exploitation threatening him almost as a matter of course under our usual methods and mores of corporate reorganization. In destroying the abuses of the holding companies, the Government must not leave great groups of helpless investors to the certain abuses of extensive hurried corporate reorganizations. The dominant groups who have ruthlessly plucked the investor in promoting some of these huge holding companies must not be allowed to pluck him again as reorganization managers.

On the other hand, if the disappearance of the holding-company excrescence is to be realistically expected at the end of a given period, there must be a constant pressure on the managers of holding-company enterprises, persistent from the very beginning of that period, to insure a continual process of whittling down complicated capital structures and of disassociating operating properties not related to each other geographically or economically. Only such a continual process can guarantee that at the end of the given period the holding companies will have been dismantled into organizations simple enough in structure to be readily dissolved if they are to dis-

solve, or sufficiently shrunk and integrated for operating purposes so that they may readily be transformed into operating companies. Without such a dismantling process holding-company liquidation at the end of the period may well cost the same sacrifice of investors' interests as would be required to effect their liquidation a year from today. The devices recommended below are devices to effect that continual pressure to compel that continual dismantling process.

2. To attain the flexibility desirable for the handling of this complicated problem in a realistic and prudent way, Federal control should be vested in an administrative commission.

* * * * * *

11. The Commission should study existing systems so that they may be simplified by the elimination of unnecessary corporate complexities and of properties which do not fit into an economically and geographically integrated whole. Simplification and reorganization of holding-company structures, making possible within a reasonable period the practical elimination of the holding company, should be conducted under the Commission's supervision over a period of time to prevent undue losses to security holders from investment dislocations. Voluntary action by the companies should be encouraged as much as possible, but the commission should be empowered

to issue orders compelling necessary divestments, dissolutions, and reorganizations. Such orders should be enforceable in the courts and the commission should act as trustee to effectuate necessary divestments, reorganizations, or dissolutions.[22]

(c) Intention that the reorganization provisions of Section 11 should bring about simplification of holding company systems without destruction of legitimate investment interests

After the drafting of bills which embodied the substance of the recommendations of the National Power Policy Committee, a controversy developed which focused primarily upon the provisions of Section 11. The heart of this controversy, as recognized by both opponents and proponents of the Act, was whether complex holding company systems could be "unscrambled" without causing additional losses to the investors who, as the National Power Policy Committee Report stated, had already been "ruthlessly plucked" (*supra*, p. 33) in the promotion of the holding companies. The epithet "death sentence", referred to by petitioner (e. g. Br., p. 17), was repeatedly

[22] Other recommendations included (1) providing tax incentives for simplification of holding-company systems, and (2) authorizing the Commission itself to institute bankruptcy reorganization proceedings for insolvent holding-company systems. The latter recommendation was reflected in the earlier holding-company bills but the Act as passed contains no provisions authorizing the Commission to institute bankruptcy proceedings.

used by the opposition to suggest that the termination of the existence of corporate entities, however useless and cumbersome they might be, would necessarily involve destruction of investment values. This charge was emphatically rejected by the proponents of the Act.[23]

One specific answer was that the reorganization safeguards of the Act would fully protect all "legitimate investment interests." Thus a Senate committee report concluded a detailed exposi-

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[23] See, for example, Senate Report No. 621, 74th Cong., 1st Sess., at p. 11, wherein it is said:

"There has been much misunderstanding of the provisions of this section in the bill originally introduced (S. 1725). It has erroneously been called a 'death sentence' upon all public-utility holding companies. It has erroneously been charged that it would confiscate the investment of the public in the utility industry. For these reasons particular explanation of this section appears in this report."

The President's message of March 12, 1935, which is printed in S. Rep. 621, 74th Cong., 1st Sess., at p. 2, states with reference to the original holding company bill as introduced in both Houses:

"* * * Such a measure will not destroy legitimate business or wholesome and productive investment. It will not destroy a penny of actual value of those operating properties which holding companies now control and which holding company securities represent insofar as they have any value. On the contrary, it will surround the necessary reorganization of the holding company with safeguards which will in fact protect the investor."

In a radio address of the President, delivered April 28, 1935, and quoted at page 3 of the same report, the President concluded with reference to the bill: "remember that it will not destroy legitimate values."

tion of the reorganization provisions of the statute by stating (S. Rep. No. 621, pp. 16–17):

> As has been explained above, the title does not require the dumping or forced liquidation of securities. Such disposition as may be necessary can be accomplished by reorganization which will equitably redistribute securities among existing security holders. * * *
>
> The individual investor in present-day holding companies should come out of any reorganization process under the title with far better securities than those with which he went into it. He should get a security which represents an actual down-to-the-rails investment in a regulated local operating company, or, at most, a regulated regional holding company. * * * The actual clearing up, through clean reorganizations, of the tangle in which holding-company finance has left the industry and those who have invested in it, can reestablish a confident, stable market for good utility securities. * * *

Once there should be provided both enabling machinery and ultimate coercive sanctions it was hoped that the public utility industry itself would be the major force in working out methods of compliance. In that connection Congressman Eicher said:

> If the compulsions of the act are made sufficiently clear to convince the interlocking lawyers of the holding-company bank-

> ers that it can't be evaded or compromised, the legal and economic imagination which put these holding-company combinations together will devise many means of taking them apart. But pending the certainty of such compulsions the legal and financial advisers of the holding companies have not been concerned to discover how the proposed legislation will work; they have only been concerned to discover reasons why it won't work.[24]

It was believed that the equity precedents in connection with antitrust decrees afforded useful analogies as to how it might be possible to remold the security holders' rights to accord with the statutory policy without destroying values. It was emphasized that under these precedents there was no necessity for maturing liquidation preferences. See, for example, the following excerpt from Congressman Ficher's "additional views" appended to the House Report to accompany S. 2796:

> Long ago, under the Sherman Antitrust Law and under the commodities clause of the Hepburn Act, the courts worked out a

[24] House Report No. 1318, at page 50; Senate Report No. 621 also stated, at page 13:

"There are many forces at work in the industry which, given the machinery and the encouragement of legislation, will undertake to set their houses in order in enlightened self-interest in the same way that groups in the field covered by the Securities Exchange Act have undertaken reforms without compulsion within the framework of that act."

technique which would permit readjustments and reorganizations, *without the acceleration of indebtedness or the maturing of rights upon liquidation,* to enable corporations to rearrange their corporate structures and divest themselves of properties to the extent required to comply with Government policy. The courts have even gone so far as to permit the equitable apportionment among several properties of a general mortgage lien theretofore attaching to those properties as an indivisible whole, without accelerating the maturity date of the mortgage, if the segregation of those properties is necessary to conform to the policy of the Federal statutory law (*Continental Insurance Co.* v. *U. S., Reading Co., et al.,* 259 U. S. 156). The allegation that the Senate bill will cut off valuable equities by the forced liquidation of assets and the dumping of securities upon a demoralized market are consequently not borne out by the provisions of the Senate bill or the judicial precedents established in analogous cases. [Italics added.] H. R. Rept. 1318, 74th Cong., 1st Sess., at pp. 49–50.[25]

[25] See also S. Rep. No. 621, 74th Cong., 1st Sess., at p. 33, wherein it is stated with reference to Section 11 (e):

"Thus the voluntary reorganizations of the holding companies might be facilitated by the recognized powers of a court of equity to make such equitable allocations of general liens and priorities as may be necessary to make it possible for the companies to comply with the policy of the stat-

As the foregoing excerpts from the legislative background indicate, the proponents of Section 11 intended that the Commission, with the aid of the federal courts, should have a mandate to bring about an industry-wide reorganization in an extraordinarily complex field and to do so in such a way as not to destroy values, but rather to safeguard the legitimate investment interests of every class of security holders affected. To the Commission this mandate requires an interpretation of the "fair and equitable" standard in such a way as to take into account the operation of Section 11 as a whole and to give recognition to the entire bundles of security holders' rights affected. Therefore, to avoid robbing Peter to pay Paul, the Commission does not treat as ma-

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ute (*Continental Insurance Co.* v. *U. S., Reading Co., et al.*, 259 U. S. 156)."

At a later point in our brief we deal with petitioner's contention that the *Reading* case *requires* treating preferred stockholders' liquidation preferences as matured in a Section 11 (e) reorganization. Irrespective of our difference with petitioner as to what might be the proper application of the *Reading* case if this were a plan to comply with the antitrust laws, we believe it significant to note from the excerpt in the text that Congress in referring to the *Reading* case regarded it as a precedent for a flexible technique for working out plans of compliance by which it would be possible to avoid "the acceleration of the indebtedness or the maturing of rights upon liquidation" where to do so would frustrate the policy of preserving legitimate investment values.

tured otherwise unmatured liquidation preferences. This is the theme of our subsequent argument.

2. For the purpose of determining whether Power's preferred stockholders were fully compensated in the plan, the Commission properly treated their otherwise inchoate liquidation preference as not matured by the processes of Section 11

(a) The test of fairness applied by the Commission prevents the processes of Section 11 from appropriating the legitimate investment interests of either class of stockholders for the benefit of the other.

The Commission stated in its opinion (R. 13) that—

> in reorganizations or liquidations to comply with Section 11, stockholders affected should be given participations according to their contractual or other rights determined *as though in a continuing enterprise*, and that the process of compliance with the statute should not be permitted to mature liquidation preferences.

If the process of bringing the United Light and Power Company holding company system into conformity with the standards of the Act were considered as maturing the liquidation preferences of the preferred stock of Power, the result would be to transfer value from the common to

the preferred stock. Apart from the Act, the common stockholders have a right to remain in the corporation, and to have the system's earnings applied, first, to pay current dividends and the arrears on the preferred stock, and then to the payment of dividends on the common stock. The factual analysis which was summarized in an earlier part of this brief indicates that this right of Power's common stock was a valuable right, i. e., that the estimated future earnings of Power's system are sufficiently great so that the common stock would in fact receive dividends in the future. If it were held, however, that the preferred stockholders were entitled to all of Railways' stock, this valuable right of the common stockholders would be destroyed and this by operation of the Act. Such a determination would be plainly inconsistent with the intent of Congress that the statute should not destroy any legitimate investment values, or cause further loss to security holders. The intent of Congress could be satisfied only by permitting the common stockholders of Power to participate in the system's rehabilitation, since those common stockholders have a legitimate investment interest in the system.

The patent unfairness of treating a liquidation preference as the sole measure of the value of the respective rights of preferred and common stockholders becomes even more apparent when we consider the impact of such a test in situations

where there are no preferred dividend arrears, but nevertheless the assets do not exceed the amount of the liquidation preference. Assume, for example, that a holding company, free from debt, has outstanding $10,000,000 par value of 6% cumulative preferred stock, with a preferred dividend requirement of $600,000 per year. Assume that the liquidation preference of this stock is also $10,000,000 or par. Assume further that the company has $900,000 of earnings which, in the light of the risks of the business, should be capitalized on a 10% basis.[26] This would indicate a value for the business of $9,000,000. Petitioner's test would note the $9,000,000 valuation of the assets and the $10,000,000 liquidation preference of the preferred stock, and would give all the assets to the preferred stockholders. But no one would seriously contend that the common stock of the hypothetical company, earning $300,000 per annum (the difference between the $900,000 of earnings and the $600,000 dividend preference of the preferred stock) had no value. Yet petitioner's test would require the Commission to treat such a common stock as having no value for purposes of a Section 11 (e) plan.[27]

[26] This was the percentage used, as a minimum, by the dissenting commissioner as applicable to the estimated income of Railways in the instant case (R. 56).

[27] See Latty, Fairness—the Focal Point in Preferred Stock Arrearage Elimination (1942), 29 Va. L. Rev. 1, 26–27:

"And it is questionable that value of an equity in a going concern is to be determined by a uniform capitalization ratio

If we add to this example the fact that there are accumulated dividends on the preferred stock, the analysis becomes more complex, but the conclusion is unchanged; there is still a value for the common stock resulting from its ultimate residual interest in earnings. When there are arrears, the value of the common stock is reduced because its right to earnings will not come into enjoyment until all accumulated dividends on the preferred stock have been paid. But even where arrears are substantial, the common stock retains its contractual right to continue in the corporation so long as it appears that foreseeable future earnings will be sufficient to pay off the arrearages and permit the payment of dividends on the common stock. In appraising this possibility of ultimate resumption of common-stock dividends in a particular case it must be recalled that the accumulated arrears are a non-interest-bearing claim.[28]

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of net income. Otherwise, pushing this theory to a logical (though academic) conclusion: Assuming 10 as a proper capitalization ratio, if I borrow $1,000,000 at 5% and put in $1,000,000 of my own, and make $100,000 net profit per year, there is, under this theory no value existing for my holdings in the enterprise; yet common sense tells us that I have a valuable interest there."

Further illustration of the difficulties with petitioner's test is that it would require the same treatment for a $4 and a $7 dividend stock of equal rank, assuming both have equal liquidation preferences.

[28] In this case Power's liquidation preference consists of (1) an initial preference of $100 per share, which is in effect the base for a 6% annual cumulative dividend claim, plus

In the present case this residual interest of the common stock cannot be ignored unless its prospect of coming into enjoyment is so remote as to make its value negligible (see note 40, *infra*). As we have seen, the factual analysis made by the Commission convinced it that, apart from the statutory requirement for reorganization, Power's common stock would ultimately participate in earnings under the existing structure. Conversely, the same factual analysis indicates that Power's preferred stock, with its limited dividend rights, and merely inchoate liquidation preferences, could not have expected to receive 100% of the future earnings. To the extent that the plan eliminated the common stockholders' residual claim to all earnings after satisfaction of the dividend preference of the preferred stock it conferred positive benefits upon Power's preferred stockholders just as clearly as it likewise conferred benefits upon the common stockholders in permitting them to share in current earnings.

Petitioner's analysis of the problem completely ignores the advantages which Power's preferred stockholders received in the elimination of 95% of the common stockholder's residual claim to income. This is because petitioner would require

(2) $64 of accumulated arrears. Using the liquidation preference as the sole test of the preferred stockholder's claim would require the same compensation for the non-interest-bearing arrears as for the initial $100 claim with its $6 annual dividend charge.

the Commission to treat the preferred stockholder's inchoate liquidation preference as having fully matured before the Commission could begin to weigh the fairness and equity of the plan. Petitioner would thus have the scales of equity weighted in advance in favor of the preferred stock by adding to their pre-existing bundle of rights the statutory requirement for reorganization.[29]

Only by this assumption can petitioner argue that "fairness and equity" require allocation of all assets to the preferred stockholders wherever the present value of the assets is less than the face amount of that liquidation preference and despite the fact that, apart from the statute, common stockholders would have a legitimate expectation of participating in future income. To hold with petitioner that the Act was intended to work such a transformation in the relative

[29] In this instance the statutory obligation to simplify the Power system was implemented and given specific form by the Commission's order of March 20, 1941. In the next section of this brief we indicate the reasons why we regard it as immaterial, in applying the fair and equitable standard here, that this order and the subsequent plan of compliance therewith may have made literally applicable the stipulated liquidation preference of the preferred stockholders when it envisaged the elimination of Power as a separate corporate entity in the system. While petitioner's argument is predicated in part upon the particular nature of the order and plan in question, the broader implications of the argument must rest essentially upon the statutory requirement for reorganization itself as the basis for maturing otherwise inchoate liquidation preferences.

rights of preferred and common stockholders is to hold that it confers a windfall on the preferred stock at the expense of the legitimate investment stake of the common stock.

The Commission rejected any such hypothesis on the ground that it would prevent realization under the Act of the kind of a rehabilitation of investors' interest which Congress had intended. As to this the Commission stated (R. 14-15):

> Clearly the intent of Congress was that the techniques employed under Section 11 should be those necessary to remove the holding-companies' concentration of economic power over operating utilities, promote local management and regulation for the benefit of consumers, eliminate unnecessary and uneconomic corporate entities, and benefit investors generally by giving them more direct interests in the operating properties and earnings *to the extent that their holding-company securities represent any real equity therein.* The liquidation of Power accomplishes an important step in this direction by giving the preferred and common stockholders a security that is better than those they have heretofore held. This process of improvement of position must not be permitted to destroy any legitimate interests of the common stock, or present a windfall to any senior security.[30]

[30] There have been omitted from the above quotation footnote references to the legislative history which we have discussed above.

The standard which the Commission thus applied in this case has been consistently applied by the Commission to all types of readjustment of stockholders' rights pursuant to the requirements of Section 11.[31] The Commission's interpretation of Section 11 (e) has been upheld by every court that has thus far had occasion to review the Commission's action.[32]

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[31] *Community Power and Light Company*, 6 S. E. C. 182 (1939), enforced 33 F. Supp. 964 (S. D. N. Y., 1940); *Federal Water Service Corp.*, 8 S. E. C. 893 (1941), remanded on another point *sub nom. Securities and Exchange Commission* v. *Chenery Corp.*, 318 U. S. 80 (1943); *Puget Sound Power & Light Co.*, Holding Co. Act Rel. No. 4255 (1943), enforced without opinion, D. Mass., unreported, 1943; *Southern Colorado Power Co.*, Holding Co. Act Rel. No. 4501 (1943), enforced without opinion, D. Colo., unreported, 1944, appeal pending *sub nom. Disman* v. *Securities and Exchange Commission*, C. C. A. 10, 1944; *Virginia Public Service Co.*, Holding Co. Act Rel. No. 4618 (1943); *International Utilities Corporation*, Holding Co. Act Rels. Nos. 4896, 4992 (1944), enforced without opinion, S. D. N. Y., unreported, 1944; *Laclede Gas Light Co.*, Holding Co. Act Rel. Nos. 5062, 5071 (1944), enforced E. D. Mo., 1944, opinion approving plan not yet reported.

[32] District court decisions are included in the preceding footnote. Petitioner in the court below placed great emphasis upon the district judge's reliance on this Court's decision in *Securities and Exchange Commission* v. *Chenery Corp.*, 318 U. S. 80 (1943), and particularly upon his reliance on the language of Mr. Justice Frankfurter with reference to the "fair and equitable" standard in Section 11 (e):

"Determination of what is 'fair and equitable' calls for the application of ethical standards to particular sets of facts. But these standards are not static. In evolving stand-

(b) There is no substance to petitioner's suggestion that the test of fairness applied here is unsound because of supposed difficulties in applying it to other types of problems

Despite this consistent course of administrative and judicial procedures applying the "fair and equitable" standard in contexts similar to the instant case, petitioner seeks to establish inconsistency in action taken or imagined, based upon other types of cases, both actual and hypothetical. While we question the relevance of this line of inquiry we summarize below the extent that the Commission has thus far come to grips with the type of problems posed by petitioner.

(i) Petitioner urges "Certainly if the preferred stockholders in the instant case had held bonds calling for a payment thereon equal to the par value and accrued interest upon a liquidation, before the common stock received anything, the contract would be recognized and the Plan denounced as not being fair and equitable" (Br., pp.

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ards of fairness and equity, the Commission is not bound by settled judicial precedents. * * *"

The Commission did not rely on the *Chenery* case in its opinion. As we understand it, that decision merely emphasizes the propriety of considering the "fair and equitable" standard in its statutory context (and in the light of an initial exercise of administrative judgment as to the proper application of the standard) rather than of trying to find the answer to a special statutory problem in judicial precedents adopted in different contexts. The Circuit Court of Appeals considered that the *Chenery* case "is not precisely apposite" (R. 137).

14–15). This, however, is an unlikely as well as an oversimplified hypothesis. If Power's preferred stock had been the ordinary type of fixed interest debentures the answer is, of course, that Power would have been in bankruptcy long prior to the Holding Company Act. If the facts were changed and the default under the indenture did not become imminent until after the effective date of Section 11 (e), and the Section 11 (e) plan had been filed as a procedural alternative to proceeding under Chapter X, then the Commission would have treated the debt as a matured claim in all respects as though the plan were to be accomplished in a bankruptcy proceeding.[33] If, however, what petitioner supposes is a freak security, called a bond, which carries an interest charge payable only in the judgment of the board of directors, and the principal obligation of which has either no maturity date or a very remote one, then the security would appear to be in all respects except in name a preferred stock. Whether the mere fact that such a security was labeled a "bond" or "debenture" should be regarded as of any significance for purposes of reorganization is a problem the Commission has never had occasion to consider.[34]

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[33] See note 46, *infra*.

[34] Nor has it had occasion to consider the status of an income bond of the type which this Court dealt with in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106. Conceivably in dealing with such an income bond the question

(ii) Petitioner also urges that the Commission's action in the instant case is inconsistent with its earlier order approving the application by Power of the proceeds of disposition of certain of its assets to the prepayment, without a premium, of Power's then outstanding debentures. That action was affirmed in *New York Trust Company* v. *S. E. C.*, 131 F. (2d) 274 (C. C. A. 2), certiorari denied, 318 U. S. 786, rehearing denied, 319 U. S. 781. We submit that no such inconsistency exists. In fact, while the dissenting Commissioner relied on the prior decisions in the premium cases, the majority found support in the same decisions for its approval of the instant plan.

Both the Commission and the circuit court of appeals decisions in that case held (1) that the indenture provision permitting the company to call the debentures for retirement at a premium was inapplicable under the circumstances, and (2) treating the contract provision for prepayment as inapplicable, the circumstance that compliance with Section 11 had compelled the sale of certain properties (leaving Power with no further use for the capital contributed by the

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whether it should be treated as a presently matured claim might turn on whether the company were found to be insolvent. It should also be noted that if the contract maturity date were a relatively near one, it might make little difference, for the purpose of determining the participation rights of the holder of the income bond, whether the contract date were adhered to or maturity accelerated.

debenture holders), made applicable the doctrine of "frustration of the venture." Under that doctrine Power was not obliged to continue paying for hire of funds for which it had no further use.[35] No attempt had been made on behalf of the debenture holders to establish that their interest in Power as a continuing enterprise was worth more than the face amount of their claim. Accordingly, there was at least as good ground for assuming that payment of a premium would be a windfall to debenture holders as that the ability to discharge the debt at its face amount in advance of maturity might be regarded as a windfall to Power's stockholders.[36]

The Commission has not treated the *New York Trust Company* case as providing a complete answer to all the problems that may be presented by plans which contemplate prepayment of debt. In subsequent cases the Commission has frequently emphasized the circumstance, not

[35] In the case of the premium on Power's debentures, there was, *pro tanto*, a liquidation in a broader sense than is involved in the instant plan, since the source of the funds used to prepay the bonds was primarily the proceeds from sales of properties made necessary by Section 11 (b) of the Act.

[36] In the Commission's brief in the circuit court of appeals in the *New York Trust Company* case it was urged that there was affirmative basis in the record for concluding that, apart from the necessity of compliance with Section 11, Power's debentures were in a position of risk at least commensurate with the contract rate of interest, and that therefore there was no basis for claiming that they had been injured by the statutory processes which had compelled prepayment of their debt.

articulated in the *New York Trust Company* case, that an appraisal taking into account interest rate, maturity date, and risk factor incident to the particular debt security which is to be prepaid would indicate that payment of face amount, without a premium, would be full compensation for premature termination of the investment through the operation of the statute.[37] Where the transaction which results in prepayment of indebtedness (while part of the action necessary to comply with Section 11) may be regarded as in some respects in the nature of a refunding rather than a withdrawal of capital from the enterprise, it has seemed particularly important to enter into this appraisal of the going concern value of the creditor's investment contract.[38]

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[37] See *North Continent Utilities Corporation*, Holding Company Act Release No. 4686, p. 12 (November 18, 1943), plan enforced in *In re North Continent Utilities Corporation*, 54 F. Supp. 527 (D. Del. 1944) (emphasizing meager earnings coverage, unfavorable market history and doubts as to ability to meet maturity five years hence); *Consolidated Electric and Gas Company*, Holding Company Act Release No. 4900, pp. 4–7 (February 21, 1944), plan enforced in *In re Consolidated Electric and Gas Company*, 55 F. Supp. 211 (D. Del. 1944).

[38] In *Cities Service Power & Light Company*, Holding Company Act Release No. 4944, p. 16 (March 15, 1944), and *Laclede Gas Light Company*, Holding Company Act Release No. 5062, pp. 26–29 (May 24, 1944), plan enforced in *Matter of Laclede Gas Light Company*, E. D. Mo., August 25, 1944, not yet reported, where at least part of the funds for retiring outstanding securities came from new financing, no premium

(iii) Petitioner further criticizes the Commission's decision in this case on the ground that a consistent application of the standard of fairness applied here might require payment in excess of liquidation preference to a preferred stock which, apart from the requirements of Section 11 (b), would be regarded as worth substantially more than its liquidation preference; e. g., by reason of a high dividend rate which appears relatively free of risk in view of earnings and asset coverage (Br., p. 20). We would scarcely regard it as a valid criticism of the standard of fairness applied in this case, that it might under converse circumstances prevent common stockholders from obtaining through operation of Section 11 a windfall at the expense of preferred stockholders. There are, however, no relevant Commission precedents, and insofar as comparable problems may be envisaged in connection with situations which are under consideration by the Commission or its staff, there are

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was paid in view of the inferior character of the securities retired. Cf. *United Gas Corporation*, Holding Company Act Release No. 5271, p. 33 (September 8, 1944), where the outstanding preferred stock which was being retired out of the proceeds of the new issue was so well protected with respect to assets and earnings that the Commission found its retirement to be not attributable to the necessity of compliance with Section 11 (b), but rather to the common stockholders' desire to avail themselves of an opportunity to obtain cheaper senior money; the plan approved by the Commission provided for its retirement at the call price.

many complexities not included in the problem as posed by petitioner.

The fairness of a proposal to pay preferred stockholders the amount of a liquidating preference, which is less than the value of continuing in the enterprise with their existing preferential dividend claim, may depend on (1) whether the common stockholders have existing voting rights sufficient as a matter of general law to cause a liquidation, (2) whether there is any equitable reason for limiting the exercise of such voting rights, and (3) whether, as a matter of construction, the particular charter provision relied on to limit the preferred stock to its liquidation preference is in fact applicable.

Depending upon the resolution of such questions, it may or may not appear that there is a problem of measuring the impact of Section 11 upon the existing bundles of rights enjoyed by the preferred and common stockholders, respectively. It is scarcely profitable to anticipate the Commission's answer to problems so different from that involved in the present case and we refer to them only to illustrate how petitioner has oversimplified the problem it has suggested.

(c) The standard of fairness applied here is to be contrasted with the inadequate standard applied in readjustments under state laws

Returning to the problem with which we are here concerned, namely, readjustment of stock-

holders' rights where there are substantial preferred stock dividend arrears, we wish to emphasize one further point. The standard employed by the Commission should not be confused with the criteria often employed in recapitalizations under state law where common stockholders are frequently permitted to exact a toll for their consent to a much needed capital readjustment. Indeed, the Commission has had occasion to call attention to the unfortunate results often reached in typical recapitalizations under state law.[39]

One weakness of the applicable state law procedure is that it does not afford any compulsion for reorganization without the consent of specified majorities of the various classes of outstanding stock. Where there are current earnings and either a capital impairment, or sheer unwillingness on the part of common-stock-dominated directors to pay dividends, preferred stockholders are under strong pressure to pay whatever price may be necessary to purchase common stockholders' consent to any recapitalization which may lead to the resumption of dividends. Common stockholders' bargaining power is enhanced by the very fact that, in view of substantial arrears, there may be only a remote expectation of common stock dividends and thus the common stock-

[39] See Securities and Exchange Commission Report on Protective and Reorganization Committees Part VII, pp. 109–187.

holders have little to lose by "sitting tight." Such state laws moreover contain no express provision for judicial review of the fairness of a recapitalization plan and the only basis for challenging the plan is the bringing of an equity suit in which the plan may not be set aside unless it is established to be "so unfair as to amount to constructive fraud" (see *Hottenstein* v. *York Ice Machinery Co.*, 136 F. (2d) 944 (C. C. A. 3, 1943)). Even if the equity court were to attempt to subject the plan to a more exacting test of fairness, it would find itself in the dilemma of being able to veto the plan before it but of having no adequate means of compelling the common stockholders to consent to a fairer plan.

These deficiencies under the typical state incorporation laws are obviated where Section 11 of the Holding Company Act is applicable because the statute makes the necessary reorganizations compulsory and provides for both administrative and judicial scrutiny of the fairness of the plan. Accordingly in Holding Company Act reorganizations common stockholders are not allowed to capitalize on mere nuisance positions [40] or to exact a

[40] In *Federal Water Service Co.*, 8 S. E. C. 893, 914 (1941), and *Southern Colorado Power Co.*, Holding Company Act Release No. 4501 (1943), the Commission excluded from participation junior common stocks having no reasonable prospect of ever receiving dividends from the corporations.

toll for the surrender of inequitable voting rights as required by the Holding Company Act.[41]

Commentators who have considered the Commission's application of the "fair and equitable" standard to recapitalization plans have agreed that the standard applied by the Commission under Section 11 (e) is one which gives the preferred stockholders far better treatment than is customary in plans which are put through in

[41] In *Young* v. *Columbia Gas and Electric Corporation*, 129 F. (2d) 216, 220 (C. C. A. 3, 1942), the Third Circuit passed incidentally upon the fairness under State law of the proposed treatment of preferred and common stockholders in a plan for reorganization of Columbia Oil and Gasoline Corporation which the court recognized was still subject to Commission authorization pursuant to the Public Utility Holding Company Act. Afterwards that plan was abandoned and a different plan proposed which was regarded as far less favorable to common stockholders of Columbia Oil, and correspondingly more favorable to preferred stockholders, than the plan which had been before the Circuit Court of Appeals in the *Young* case. The new plan was approved by the Commission. The Commission indicated that in appraising the relative equities of preferred and common stock for purposes of Section 11 (e) it could not take into account potential weakness in the antecedent strategic position of the preferred stockholders owing to the possible abuse by the common stockholders of their voting rights, a circumstance which had been given weight in connection with the prior plan. The order of the Commission which affirmed the new plan for Columbia Oil was affirmed on review by the same court which had previously decided the *Young* case. See *Columbia Oil and Gasoline Corporation*, Holding Company Act Release No. 3886, pp. 26–27, order of Commission affirmed *sub nom. Marquis & Co.* v. *Securities and Exchange Commission*, 134 F. (2d) 822 (C. C. A. 3, 1943).

accordance with state law. See Latty, *Fairness—The Focal Point in Preferred Stock Arrearage Elimination* (1942), 29 Va. L. Rev. 1, 27–39; Dodd, *Fair and Equitable Recapitalizations*, (1942) 55 Harv. L. Rev. 780, 796–806, 816; and see also a subsequent article by Dodd reviewing the decision of the Commission and the district court in the instant case, entitled *The Relative Rights of Preferred and Common Shareholders in Recapitalization Plans Under the Holding Company Act* (1944), 57 Harv. L. Rev. 295.

Power's preferred stockholders have thus been greatly benefited by the mandatory requirements for simplification of the holding company system contained in Section 11. They have thereby been relieved from any necessity of paying a price to obtain common stockholders' consent to a much needed reorganization. They have had the further protection of the application by both the Commission and the district court of a far more sensitive appraisal of fairness than has hitherto been applied in recapitalizations not affecting creditors' rights. Instead of being satisfied with these tremendous benefits, petitioner seeks to make a fetish of a single one of the bundle of rights involved, namely, the liquidation preference. The Court is urged to hold that, unless preferred stockholders can be permitted to realize that liquidation preference in full, no plan is fair to them even though it gives them new securities

which fully represent, upon over-all analysis, their relative interest in the preexisting enterprise.

Such a holding would vindicate the defeatist attitude of those who claimed that it was impossible to simplify the holding company systems without destructive consequences to investors. It is not without significance that petitioner bases its argument on the hypothesis that Section 11 should be regarded as a "death sentence" (Br. 17). It is submitted that the Court should not construe the Act in a manner so clearly contrary to the intention of Congress.

3. The standard applied by the Commission fully recognizes the "absolute priority" of Power's preferred stock in its relevant context.

The Commission was, of course, fully conscious of this Court's holding in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, that the words "fair and equitable" had come to be "words of art" as used in connection with reorganizations accomplished through equity receiverships, and that Congress must have used these words in Section 77B of the Bankruptcy Act as importing their historic meaning, and as therefore requiring recognition of "absolute priority" of senior interests.[42] For similar reasons the Commission construes the words "fair and equitable" in Section 11 (e) as requiring recog-

[42] It will be recalled that the Commission joined in a brief *amicus curiae* in support of the petitioner in that case.

nition of "absolute priorities." It does not regard the Act as a composition statute.[13] It is only with respect to the question of just what are the "absolute priorities" of Power's preferred stockholders for which they are entitled to be compensated, that there is any difference of opinion with petitioner or within the Commission.

Referring to Commissioner Healy's views, the majority of the Commission said (R. 16):

> It is pointed out in Commissioner Healy's separate opinion that the words "fair and equitable" embodied in Section 11 have a

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[13] Section 11 (e) contains no requirement for vote of security holders on a plan, and it is, of course, inconsistent with the affirmative requirements of Section 11 (b) that any class of security holders should have a veto on compliance with the statute. The present plan does not provide for any vote. Some of the plans which the Commission has considered under the standards of Section 11 (e) have provided for a vote of security holders. Indeed, a provision for a vote has been held an immaterial part of a plan, relating only to the mechanics of execution. For that reason a federal district court decreed enforcement of a plan that provided for a stockholders' vote in accordance with the State law, although there was an unresolved controversy as to whether the vote so obtained did meet the requirements of State law. See *Application of Securities and Exchange Commission*, 50 F. Supp. 965 (D. Del., 1943).

The Commission does not regard a provision for a vote as affecting the extent of its responsibility to be satisfied that the plan is fair to every interest affected. For similar reasons we do not concur in Power's emphasis (Br., pp. 5, 6, 27) upon the absence of any objection before the Commission to even the allocation proposed by Power. The Commission did not regard this absence of objection as relieving it from the duty of reducing the common stockholders' participation to the lesser amount which it regarded as "fair and equitable".

> settled meaning, as determined by the courts, and that an application of the "absolute priorities" doctrine must result in no distribution to Power's common stock in this case. But that is because he measures the rights of the preferred stock as they would be measured in bankruptcy cases, and not merely because he follows the "absolute priorities" doctrine in determining the consequences of the measurement. In other words, we can agree with him when he says that absolute priorities must be respected, because we think that doctrine simply means that the common stock must not be accorded any participation unless the preferred stock has been fully compensated for its rights and priorities. But there the area of agreement stops, because he says further that the rights and priorities of the preferred stockholders are the same here as in bankruptcy cases, where their claims to liquidation preferences (including dividend arrearages) are treated as matured. In our view it would be unconscionable and contrary to the plain intention of Congress to so hold.

The basis upon which the majority concluded that the Section 11 (e) reorganization process should not be treated as maturing Power's liquidation preference and that in that respect the equity and bankruptcy precedents are inapplicable is that the latter precedents (R. 12)—

> are predicated on sets of facts fundamentally distinguishable from the situation

> arising here. In bankruptcy or equity reorganizations * * * Creditors and other claimants are prevented from foreclosing or otherwise compelling an actual liquidation, but new securities are distributed among them according to their contractual and other rights determined *as though in liquidation.* * * *
>
> On the other hand, Power is a company virtually without debt and under no financial embarrassment in the traditional bankruptcy or equity sense.

As the Commission indicated, there is a substantial difference between the impact of the Section 11 (e) reorganization process here and the typical situation in a bankruptcy reorganization. In bankruptcy reorganization the compulsion for change comes from a debt default (existing or prospective) and from the ability of the creditors to force action.[11] It is because the bankruptcy

[11] Petitioner urges that there is no real distinction between reorganizations under the Act and bankruptcy reorganizations, and particularly that *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, dealt with the rights of stockholders vis-a-vis holders of income bonds which had not matured prior to the institution of the proceedings. However, the company had filed a voluntary petition under Section 77B and had admitted therein its insolvency, thereby invoking the ordinary bankruptcy principle which permits proof of claims whether matured or unmatured. The particular language from this Court's opinion quoted at pages 18–19 of petitioner's brief, read in its context, indicates only that a company filing a voluntary petition under Section 77B, and admitting its insolvency, cannot exact a price for that admission so as to entitle stockholders to a participa-

reorganization procedure is regarded as a statutory short-cut to the result which might have been reached by judicial sale that the equity receivership precedents have been regarded as fully applicable to the Bankruptcy Act test of "fair and equitable." [45] Readjustment under Section 11 is

tion which would not have been warranted had creditors succeeded in instituting an involuntary proceeding. That decision has no relevance to the question whether the reorganization provisions of the present Act should be construed as intended to mature, without compensating allowances, otherwise unmatured and inchoate liquidation preferences.

[45] Petitioner (Br., p. 15) cites lower federal court precedents and a footnote to *Case* v. *Los Angeles Lumber Products Company*, *supra*, to the effect that the "absolute priority" rule applies in bankruptcy as between classes of stockholders. Petitioner is here using "absolute priority" as synonymous with recognition of liquidation preferences as the sole test of the rights of a senior stock. Treating the bankruptcy reorganization process as a substitute for judicial sale of the assets of a company which is insolvent in either the equity or the bankruptcy sense, makes such an approach appropriate in a bankruptcy reorganization, since a judicial sale or its equivalent under pressure from creditors would be a "liquidation" within the fair intendment of the conventional charter provisions for liquidation preferences. The cases relied on by petitioner are accordingly entirely consistent with the principles applied by the Commission in the administration of Section 11 (e) of the Holding Company Act. These cases are also in accordance with the position which the Commission has followed in the discharge of its advisory functions pursuant to Chapter X of the Bankruptcy Act. It has been noted that the test applied by the Commission to stockholders' readjustments under Section 11 (e) of the Holding Company Act permits no recognition for a junior stock so hopelessly "under water" as to have no reasonable prospect of participation in future income under the existing structure. See note 40, *supra*.

substantially different. Indeed, Power is typical of many companies which require readjustments because of the provisions of Section 11 of the Holding Company Act but which have little or no debt outstanding and no problems with their creditors.[46] Nevertheless, the existence of a top-heavy stock capitalization (which impairs the ability of the company to raise new capital), and of arrears of preferred dividends and deficits in the earned surplus accounts, makes readjustment an urgent necessity apart from the requirements of the Act. However, were it not for the impact of the Act, Power's preferred stockholders could obtain such a reorganization only by coming to terms with the common stockholders and making whatever concessions this might entail.

As we have seen, Congress, in providing machinery to compel reorganization under such circumstances, did not intend to change the substantive nature of the preferred stockholders' contract by maturing their otherwise inchoate liquidation preference. Once this is recognized it is clear that the standard of fairness applied by

[46] Where a registered holding company, unable to meet maturing indebtedness, has been reorganized under Section 11 (e) in lieu of resorting to Chapter X of the Bankruptcy Act, the Commission has, of course, applied the "fair and equitable" standard precisely as if the plan were to be accomplished under Chapter X. *In re Jacksonville Gas Company*, Holding Company Act Release No. 3570 (1942), plan enforced *In re Jacksonville Gas Company*, 46 F. Supp. 852 (S. D. Fla. 1942).

the Commission gave Power's preferred stock their "absolute priority." As the court below observed (R. 134), what the Commission did was strictly in accordance with the test prescribed in *Group of Institutional Investors* v. *C., M., St. P. & P. R. Co.*, 318 U. S. 523, 565, where this Court stated:

> It is sufficient that each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered.

II

THE CIRCUMSTANCE THAT THE STATUTORY READJUSTMENT IN THIS CASE TOOK THE FORM OF A LIQUIDATION OF POWER IS NOT DETERMINATIVE OF THE RIGHTS OF THE PREFERRED AND COMMON

Once having concluded that it is the purpose of the Act to preserve, through "fair and equitable" plans, equities of the type represented by Power's common stock, the majority of the Commission held that it could not treat the order prescribing a particular *form* of reorganization as reducing or eliminating the substantive rights of Power's common stockholders vis-a-vis the preferred by maturing the latter's otherwise inchoate liquidation preference. Instead, the liquidation of Power as a separate corporate entity was treated as a mere procedural mechanism for accomplishing reorganization and not as necessitat-

ing a different substantive result from that which would be "fair and equitable" in a recapitalization or merger.

The choice of this particular procedure had been dictated upon purely practical grounds. The *substance* of what the Commission had concluded to be necessary for the simplification of the system was elimination of the stratified character of the stock interest in Power and reduction of the number of corporate entities between the security holders of Power and the basic income-producing properties.

The Commission's opinion in connection with its order of March 20, 1941, clearly indicates the pragmatic nature of the determination that Power should be liquidated as the initial step in the simplification of its holding company system (R. 107–108). Even the selection of Power rather than one of the subsidiary holding companies as the first corporate entity to be eliminated was a matter of practical choice rather than absolute statutory necessity. Even if there had been no possible alternative other than to begin with the elimination of Power as a corporate entity, this could have been accomplished in a number of possible, although less practical, alternative ways—such as the merger or consolidation of Power and Railways, or a one-stock reorganization of Power, followed by dissolution.

The method chosen was deemed to be most economical and expeditious, in the interest of pre-

ferred and common stockholders alike,[47] and, as well, most appropriate in view of the mandate of Section 11 (b) that the Commission proceed "as soon as practicable." The usual considerations for allowing latitude for administrative flexibility in the choice of procedures are particularly applicable here in view of the express injunction of Section 1 (c) that all of the provisions of the Act shall be construed "to meet the problems and eliminate the evils" connected with holding company systems. *Cf. Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U. S. 134, 143. Under these circumstances, to permit the formal device chosen for accomplishing the reorganization to determine the substantive results would be bad public policy and bad law. The only effect would be to indicate that one particular formal device must be avoided by the parties in a corporate readjustment under the Act.

From a legal point of view, we submit that if employment of the device of liquidation matures liquidation preferences which are otherwise in-

[47] It is the consensus of financial comment that liquidation of holding companies will result in increasing the market value of the aggregate security interests affected. See, e. g., *Barrons*, Vol. XXIII, No. 40, p. 15; *The Outlook* (publication of Standard and Poor's Corporation), Vol. 15, No. 13, sec. 1, p. 822, March 29, 1943; *Moody's Stock Survey*, Vol. 33, No. 13, p. 746. In that respect there is no parallel such as petitioner would draw (Br., p. 16) between the termination of useless corporate entities in compliance with Section 11 (b) and a Prohibition Act which puts an end to the operation of a profitable business.

choate, a court would have to hold unfair and inequitable any plan employing the device of liquidation and thereby shifting substantive rights from one group of security holders to another. If we are right under Point I in urging that the common stockholders have valuable existing rights in Power, and if we are right that these rights would be protected in a recapitalization, merger, or consolidation, it would be unfair and inequitable to approve a plan the formal aspects of which would deprive the common stockholders of these substantive rights."[48]

Petitioner apparently does not challenge the proposition that the fortuitous choice of a particular procedure for accomplishing the simplification of a holding company system should not determine the substantive application of the "fair and equitable" standard. In fact petitioner appears to be in complete agreement with our position in stating (Br., p. 26): "It makes no difference in the application of that [fair and equitable] standard what device be used, whether liquidation and dissolution, recapitalization, or merger." Petitioner's argument is merely that Power is no longer (at p. 22) "a free agent in the

[48] Thus, any decision of this Court upholding the Commission's position on Point I, but rejecting the contention that it could achieve the same results in a liquidation, would be in effect a mandate to accomplish a similar division of Power's interest in Railways by following a more devious procedure—a result which could be of no practical benefit to preferred stockholders.

sense that it can recapitalize, merge, consolidate, or take other unregulated corporate action without having to comply with the standards of the Act"—a proposition with which we are, of course, in complete agreement. Petitioner then argues that whatever form the readjustment may take the preferred stockholder's liquidation preference must be treated as a matured claim. This is the contention that we have dealt with in the preceding sections of this brief.

Since, as we have shown, the "fair and equitable" standard in its context and legislative history means that Section 11 should be administered so as to avoid the destruction of legitimate investment values, it is clear that in order to effectuate that policy the charter liquidation preference could be disregarded like any other preexisting contractual provision which comes within the reach of Congress under the commerce power. As this Court held in *Philadelphia, Baltimore and Washington Railroad Co.* v. *Schubert*, 224 U. S. 603 (1912), in invalidating a contract which conflicted with the policy subsequently declared in the Federal Employers Liability Act:

> The power of Congress in its regulation of interstate commerce * * * was not fettered by the necessity of maintaining existing arrangements and stipulations which would conflict with the execution of its policy. To subordinate the exercise of the Federal authority to the continuing

> operation of previous contracts, would be to place, to this extent, the regulation of interstate commerce in the hands of private individuals and to withdraw from the control of Congress so much of the field as they might choose by prophetic discernment to bring within the range of their agreements. The Constitution recognizes no such limitation. It is of the essence of the delegated power of regulation that, within its sphere, Congress should be able to establish uniform rules, immediately obligatory, which as to future action should transcend all inconsistent provisions. Prior arrangements were necessarily subject to this paramount authority.

See, also, *Norman* v. *Baltimore & Ohio R. Co.*, 294 U. S. 240, 307–8.

In *Continental Insurance Company* v. *United States, Reading Co., et al.*, 259 U. S. 156, commonly referred to as the *Reading* case, which was much cited in the legislative history of Section 11, this Court held that "the power of the court under the Sherman Anti-Trust Law to disregard the letter and legal effect of the bonds and general mortgage under the circumstances of this case, in order to achieve the purpose of the law, we can not question."

As noted earlier in this brief, the *Reading* case was considered to furnish an example of a reorganization technique affording sufficient flexibility to permit the carrying out of Section 11 without

impairment of existing legitimate investment interests, and specifically without maturing liquidation preferences (p. 39, *supra*). Petitioner, however, relies on this case as authority for treating liquidation preferences as the sole measure of participation as between different classes of stockholders. This argument is predicated upon the fact that the *Reading* plan in addition to modifying bondholders' rights also contemplated a partial distribution of assets between holders of common stock and holders of noncumulative preference stock (which incidentally had no liquidation preference), and that the allocation among stockholders was determined in accordance with charter provisions. However, the case turned entirely upon the interpretation of the relevant charter provisions and no articulation was given to the "fair and equitable" concept as a reorganization standard. In fact, both the charter rights involved and the nature of the plan are so different from those presented in the instant case that we should hesitate to predict just what disposition the Commission would find to be "fair and equitable" if it were confronted by similar charter provisions and a similar type of plan.[49] Thus, we

[49] The Reading Company preferred stock had a noncumulative dividend preference but was entitled to share equally with common stockholders in liquidation. The plan effected a divestment of the coal properties by transferring them to a new corporation and permitting the Reading Company stockholders to purchase at $2.00 a share certificates entitling them, or their assignees, to receive stock in the new coal com-

question whether Congress intended that the anti-trust decisions should furnish a pattern for the substantive results which might govern in the innumerable reorganizations which Congress foresaw might be necessary to comply with Section 11 of the Holding Company Act.

Petitioner in any event does not question the applicability of the *Reading* case as authority for substantial modification of contract rights where the result is "fair and equitable". Again the area of disagreement between ourselves and petitioner appears to be a narrow one. Petitioner has no difficulty with the power of Congress under the

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pany upon proof that they were no longer interested in the railroad part of the business. The rights had been quoted in the market at from $11 to $20 a share. The Court's analysis indicated that there had been no prospect of payment of a dividend in any such amount apart from the compulsion of the decree, and this aspect of the plan was treated as in effect a liquidation dividend. Under the terms of the charter all classes of stockholders shared alike in liquidation. The common stockholders had a right to current dividends only out of net profits "from the business of any particular fiscal year excluding undivided net profits from previous years," after providing for the preferred dividend from the profits of the particular year. Since there had been an accumulation of undivided profits from prior years and since the preferred stockholders' remaining interest in the Railroad was substantially diminished in value as a result of the divestment of the Coal Company, there is nothing to indicate that the subscription rights in dispute were anything more than the reasonable compensation for the rights surrendered. It is not surprising, therefore, that no one suggested any reason why it might be inequitable to follow the contract provisions.

commerce clause to take away not only the inequitable voting rights of the common stockholders but also their right to have the enterprise (here referring to the enterprise of Power as a holding company) "keep going" (Br., p. 19). But surely the same considerations which warrant exercise of the commerce power to make these substantial changes in the rights of Power's common stockholders would also sustain a modification of the contractual relations between the preferred and common stockholders so as to permit recognition in a plan of the existing legitimate investment interests of each. We have seen that only in this way is it possible for Section 11 to operate as Congress intended.

Petitioner, by focusing exclusively upon the liquidation preference rather than the entire bundle of rights affected by the statutory reorganization process, urges that there can be no modification which will substitute for that liquidation preference any other measure of the preferred stockholders' rights of participation. To that extent petitioner overlooks the fact that the very essence of the reorganization process is the remaking of contract rights and the substitution of equitable equivalents therefor. The equity receivership and bankruptcy precedents, upon which petitioner places so much reliance (although, as we have seen, they are not completely

applicable), do in fact illustrate this disregard of the letter of particular contract rights in order to achieve a result which best protects the substance of all the rights affected.

In *Continental Illinois National Bank & Trust Co.* v. *Chicago, R. I. & P. R. Co.*, 294 U. S. 648 (1935), it was held that a court acting under the reorganization sections of the Bankruptcy Act may enjoin exercise of a contractual right to sell pledged securities pending reorganization. In *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482 (1913), and other cases, the courts without statutory direction imposed equitable limitations on the untrammeled exercise of the right of bondholders to foreclose, to bid in the property, and to dispose of it as they saw fit.[59] Similarly the "up-

[59] The decisions of this Court in the *Monon* case, *Louisville Trust Co.* v. *Louisville, New Albany and Chicago Ry.*, 174 U. S. 674 (1899), and the *Boyd* case, were criticised by leaders of the reorganization bar as unduly restricting the contract right of senior bondholders to sell the properties under a practical arrangement by which stockholders might be induced to contribute new money. See Paul D. Cravath, lecture dated March 1 and 8, 1916, before the Association of the Bar of the City of New York, printed in "Some Legal Phases of Corporate Financing Reorganization and Regulation":

"Three years ago the Supreme Court, in a decision foreshadowed by its opinion in the *Monon* case, placed a very serious and unexpected limitation upon the power of mortgage bondholders to deal in reorganizations with property purchased at foreclosure sale. I refer to the decision in *Northern Pacific Railroad Company* v. *Boyd*."

set price" doctrine created by the courts is a limitation on the contract right to foreclose.[51]

The bankruptcy reorganization legislation merely carried this process one step further in making it possible to dispense with the foreclosure sale entirely and to substitute a procedure under which the court's approval of a plan directly modifies in accordance with its provisions the preexisting claims of security holders.

Petitioner does not question the fact that the reorganization process under the Holding Company Act, as well as in bankruptcy, and in connection with equity receiverships, can completely remake the contract rights of senior and junior securities by reducing both to the same rank.[52] From petitioner's concessions (*supra*, pp. 69–70) it follows that if the results reached in this case could have been accomplished through a recapi-

[51] Control over the upset price was used by the equity courts both to prevent sales in furtherance of what appeared to be an unfair plan and to coerce dissenters' acquiescence in plans that did appear fair. See Weiner, *Conflicting Functions of the Upset Price in a Corporate Reorganization* (1927), 27 Col. L. Rev. 132; S. E. C. Report on Protective and Reorganization Committees, Part VIII (1940), pp. 37 ff.

[52] This Court so held in *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510, and similar results are commonplace in the simplification of the complex structures of holding company systems. In addition to the cases cited in footnote 31, *supra*, see *Commonwealth & Southern Corp.* v. *S. E. C.*, 134 F. (2d) 747 (C. C. A. 3, 1943); *Central and South West Utilities Co.* v. *S. E. C.*, 136 F. (2d) 273 (App. D. C. 1943). Both cases affirmed orders of the Commission requiring "one stock" recapitalizations.

talization of Power, then it is immaterial that this plan is to be consummated through a liquidation which falls within the letter of the charter provision defining the preferred stockholders' preference on liquidation.

Once it be established that the reorganization process may go to the very essence of the respective positions of preferred and common stock by reducing both classes to a common level, it would be anomalous to conclude that any one of the contract rights involved becomes controlling merely because literally applicable to the particular procedural device selected for accomplishing the reorganization, and although adherence to the particular provision would require an inequitable result.

Furthermore, the holding of the majority of the Commission refusing to give literal effect to the charter liquidation preference of the preferred will not disappoint any reasonable expectation of the preferred stockholders. The contingency which allegedly has matured liquidation preferences is one which could not have been anticipated by the parties when the preferred stock was issued in 1929 before the passage of the Holding Company Act.[53]

[53] Indeed, it might well be argued that the contract provision could be disposed of merely by a construction concluding that it is not applicable. A charter provision does not control, even though literally applicable, when the parties did not contract with reference to the contingency that has

Finally, in no realistic sense is there occurring in this case a dissolution of a business enterprise which should call for the application of a charter liquidation preference. As the opinion of the majority of the Commission discloses, the preferred and common stockholders of Power have been the residual co-owners of a vast public utility system controlled through Power, the top holding company, and Railways, its principal subholding company subsidiary. These stockholders will continue to remain the residual owners of the same public utility system, for the principal result accomplished by the Commission's order

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arisen. In *Chicago, Milwaukee & St. Paul Ry. Co. v. Hoyt*, 149 U. S. 1, 15 (1893), the Supreme Court said:

"But where the event is of such a character that it cannot be reasonably supposed to have been in the contemplation of the contracting parties when the contract was made, they will not be held bound by general words, which, though large enough to include, were not used with reference to the possibility of the particular contingency which afterwards happens."

Obviously, the draftsmen of Power's charter did not have in mind the contingency which is now occurring. The preferred stock was issued in 1929, long before the Act was passed. The reference to involuntary dissolution or liquidation was intended, we believe, to cover dissolutions or liquidations compelled by creditors or by reason of nonpayment of franchise taxes, illegal conduct, or the like; not to cover dissolutions incidental to the enforcement of a subsequently enacted public policy which was not and could not have been foreseen in 1929.

However, the Commission chose not to rest its decision on construction of the charter provisions and decided the case on the grounds stated in the text.

is to crack off one of the corporate shells through which their residual ownership was held and to transfer their interests to the stock of the next corporate entity, Railways. In essence, therefore, while Power is being dissolved the enterprise is not.

CONCLUSION

For the reasons stated, the judgment below should be affirmed.

Respectfully submitted.

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APPENDIX A

PERTINENT PROVISIONS OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

SECTION 1. (a) Public-utility holding companies and their subsidiary companies are affected with a national public interest in that, among other things, (1) their securities are widely marketed and distributed by means of the mails and instrumentalities of interstate commerce and are sold to a large number of investors in different States; (2) their service, sales, construction, and other contracts and arrangements are often made and performed by means of the mails and instrumentalities of interstate commerce; (3) their subsidiary public-utility companies often sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce; (4) their practices in respect of and control over subsidiary companies often materially affect the interstate commerce in which those companies engage; (5) their activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies.

(b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on

Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the States having jurisdiction over subsidiary public-utility companies; when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies; when such securities are issued by a subsidiary public-utility company under circumstances which subject such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions;

(2) when subsidiary public-utility companies are subjected to excessive charges

for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States;

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

(4) when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or

(5) when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital.

(c) When abuses of the character above enumerated become persistent and wide-spread the holding company becomes an agency which,

unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

SEC. 7. (c) The Commission shall not permit a declaration regarding the issue or sale of a security to become effective unless it finds that—

(1) such security is (A) a common stock having a par value and being without preference as to dividends or distribution over, and having at least equal voting rights with, any outstanding security of the declarant; (B) a bond (i) secured by a first lien on physical property of the declarant, or (ii) secured by an obligation of a subsidiary company of the declarant secured by a first lien on physical property of such subsidiary company, or (iii) secured by any other assets of the type and character which the Commission by rules and regulations or order may prescribe as appro-

priate in the public interest or for the protection of investors; (C) a guaranty of, or assumption of liability on, a security of another company; or (D) a receiver's or trustee's certificate duly authorized by the appropriate court or courts; or

(2) such security is to be issued or sold solely (A) for the purpose of refunding, extending, exchanging, or discharging an outstanding security of the declarant and/or a predecessor company thereof or for the purpose of effecting a merger, consolidation, or other reorganization; (B) for the purpose of financing the business of the declarant as a public-utility company; (C) for the purpose of financing the business of the declarant, when the declarant is neither a holding company nor a public-utility company; and or (D) for necessary and urgent corporate purposes of the declarant where the requirements of the provisions of paragraph (1) would impose an unreasonable financial burden upon the declarant and are not necessary or appropriate in the public interest or for the protection of investors or consumers; or

(3) such security is one the issuance of which was authorized by the company prior to January 1, 1935, and which the Commission by rules and regulations or order authorizes as necessary or appropriate in the public interest or for the protection of investors or consumers.

(d) If the requirements of subsections (c) and (g) are satisfied, the Commission shall permit a

declaration regarding the issue or sale of a security to become effective unless the Commission finds that—

(1) the security is not reasonably adapted to the security structure of the declarant and other companies in the same holding-company system;

(2) the security is not reasonably adapted to the earning power of the declarant;

(3) financing by the issue and sale of the particular security is not necessary or appropriate to the economical and efficient operation of a business in which the applicant lawfully is engaged or has an interest;

(4) the fees, commissions, or other remuneration, to whomsoever paid, directly or indirectly, in connection with the issue, sale, or distribution of the security are not reasonable;

(5) in the case of a security that is a guaranty of, or assumption of liability on, a security of another company, the circumstances are such as to constitute the making of such guaranty or the assumption of such liability an improper risk for the declarant; or

(6) the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers.

SEC. 11. (a) It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary com-

pany thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system: *Provided, however*, That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system

without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems.

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly

or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24.

(c) Any order under subsection (b) shall be complied with within one year from the date of such order; but the Commission shall, upon a

showing (made before or after the entry of such order) that the applicant has been or will be unable in the exercise of due diligence to comply with such order within such time, extend such time for an additional period not exceeding one year if it finds such extension necessary or appropriate in the public interest or for the protection of investors or consumers.

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public

interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies

and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

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APPENDIX B

REPORT OF NATIONAL POWER POLICY COMMITTEE ON PUBLIC-UTILITY HOLDING COMPANIES

This report does not attempt to give a comprehensive factual analysis of the position of the holding company in the structure of the electric and gas industries. Those facts have been compiled by the Federal Trade Commission in the course of its thorough investigation of public utility holding companies, and the results of that study have already been reported to the Senate. We are informed that a special report has been prepared for the House Committee on Interstate and Foreign Commerce by Dr. Walter M. W. Splawn, now a member of the Interstate Commerce Commission.

Numerous studies have already shown, and the report of the Federal Trade Commission further demonstrates, that the concentration of control in the electric and gas industries through the device of the holding company has assumed tremendous proportions. While the distribution of gas or electricity in any given community is tolerated as a "natural monopoly" to avoid local duplication of plants, there is no justification for an extension of that idea of local monopoly to embrace the common control, by a few powerful interests, of utility plants scattered over many States and totally unconnected in operation. Such intensification of economic power beyond

the point of proved economies not only is susceptible of grave abuse but is a form of private socialism inimical to the functioning of democratic institutions and the welfare of a free people. In 1933, after an investigation of stock ownership in railroads, Congress amended the Interstate Commerce Act to curb the further use of the holding company as a device for the control of the great transportation systems (U. S. C., title 49, sec. 5). The Banking Act of 1933 provides a measure of control over holding companies in the banking field (U. S. C., title 12, sec. 61). Congress has not yet taken any action regarding the holding company in the gas and electric utility field.

In 1925 holding companies controlled about 65 percent of the operating electric utility industry. By 1932 thirteen large holding groups controlled three-fourths of the entire privately owned electric utility industry, and more than 40 percent was concentrated in the hands of the three largest groups—United Corporation, Electric Bond & Share Co., and Insull. Even these three systems are not totally independent. United Corporation has a stock interest in Electric Bond & Share Co. Into the latter system have been brought certain Insull properties since the collapse of the Insull empire. In 1929 and 1930 twenty large holding-company systems controlled 98.5 percent of the transmission of electric energy across State lines.

The rise to power of the large holding company in the gas utility industry has been no less startling than in the field of electricity. In 1932 eleven holding-company systems controlled 80.29 percent of the total mileage of natural-gas trunk pipe lines, upon which the gas fields are almost

completely dependent for the marketing of their product.

By the pyramiding of holdings through numerous intermediate holding companies and by the issue, at each level of the structure, of different classes of stock with unequal voting rights, it has frequently been possible for relatively small but powerful groups with a disproportionately small investment of their own to control and to manage solely in their own interest tremendous capital investments of other people's money. And the ownership of the stock of operating companies is but one of many devices by which a few clever men have woven the amazing network of control and influence with which they have enveloped and entangled large sectors of the gas and electric utility industry. Voting trusts, interlocking directors and officers, management contracts, the control of proxies, and other means, all have been facilely used to bring about a concentration of control in fewer and fewer hands.

The growth of the holding-company systems has frequently been primarily dictated by promoters' dreams of far-flung power and bankers' schemes for security profits, and has often been attained with the great waste and disregard of public benefit which might be expected from such motives. Whole strings of companies with no particular relation to, and often essentially unconnected with, units in an existing system have been absorbed from time to time. The prices paid for additional units not only have been based upon inflated values but frequently have been run up out of reason by the rivalry of contending systems. Because this growth has been actuated

primarily by a desire for size and the power inherent in size, the controlling groups have in many instances done no more than pay lip service to the principle of building up a system as an integrated and economic whole, which might bring actual benefits to its component parts from related operations and unified management. Instead, they have too frequently given us massive, overcapitalized organizations of ever-increasing complexity and steadily diminishing coordination and efficiency.

For all this concentration so dangerous to his democracy, the American consumer pays the bill. With a large and often unsound capitalization to support, many holding companies have not been able to be satisfied with reasonable dividends on the securities of their operating companies. They have compelled the consumer to bear the burden of various fees, commissions, and other charges which they levy against their subsidiaries. They take fees, usually a percentage of the gross revenues of the subsidiary, under contracts for the performance of management, engineering, accounting, publicity, legal, tax, and other general and special services. They make profits on the sale of materials to their subsidiaries. They make profits from construction contracts which they negotiate and perform for their subsidiaries; they often control one or more construction companies to which is awarded most of the building work for the entire system. They take fees for handling the issue, sale, and exchange of securities for their subsidiaries.

These profits and fees, when dictated by the holding company sitting on both sides of the

transaction, in nowise represent bargains freely and openly arrived at by subsidiary companies on the basis of the lowest cost in a competitive market. There is no semblance of arm's-length bargaining. Competition for construction and other work of public-utility companies in many instances has been substantially eliminated. Independent private enterprise has been crowded out in favor of a none too benevolent private paternalism.

The promoters of the holding-company patchwork have too frequently burdened the operating industry with security charges far beyond the value of the holding company to the industry. Many holding-company securities were issued to acquire new properties, frequently from corporate insiders, at prices often far in excess of any reasonable estimate of the value of those properties and seemingly without heed of the fact that utility properties are required to serve the public under a limitation, in theory at least, of a reasonable return on "value."

The investigation of the Federal Trade Commission shows, for instance, that in 1929 Associated Gas & Electric Co. acquired 94,005 shares of Barstow Securities Corporation, a utility holding company which controlled General Gas & Electric Corporation which controlled a chain of operating companies. The price paid was $531.04 a share. According to the accountants of the Federal Trade Commission, the stock had a book value of $2.97 per share and had earned $4.16 per share in the preceding year. The acquisition was a victory for Associated Gas over the United Gas Improvement Co. (a member of United Cor-

poration group) which had bid against Associated Gas for the property. To finance its purchase of these Barstow securities, with annual earnings of about $391,000, Associated Gas incurred obligations whose annual interest charges were $2,800,000. The example is an extreme one, but acquisitions of properties were common at two, three, or more times their book value, an entry not likely to be understated in an industry where returns are regulated in relation to property value.

Such transactions obviously have no place in a sound economy. They do not serve orderly investment of the Nation's capital in the utility industry. Instead they inject a temporary and unhealthy stimulation into the securities markets which discourages intelligent permanent investors. Real development springs from stable and predicable markets. But stability in the investment market does not very often make a $2.97 stock worth $531.04, nor does it bring old-era profits to investment bankers and brokers. Fundamentally the holding-company problem always has been, and still is, as much a problem of regulating investment bankers as a problem of regulating the power industry. As the Federal Trade Commission states in its report:

> Professional managements apparently often give greater attention to the counsel of bankers than to the interest of widely scattered security holders who are the equitable owners of the company so managed * * * In the heyday of holding-company exploitation just prior to the depression, investment bankers not only fur-

nished financial aid when requested by holding companies, but solicited it and came to depend upon holding companies for business.

It is little wonder that these financial holding-company securities have so frequently turned out to be poor investments, for which many investors were induced to exchange their relatively well-secured obligations and stocks of operating utility companies. Too late the investor discovered the difference between the regulated operating companies and unregulated holding companies, and learned how much of his money had been wasted in feeding the hopes and greed out of which vast utility empires were conjured, and how little used to build up the utility enterprise.

Determination of the actual investment in utility properties is the very foundation of any intelligent public regulation of the rates of privately owned and operated utilities. No realistic determination of that kind can be made while holding companies may acquire properties and securities and engineer their transfer through many corporate conduits at fictitious prices. While Federal legislation does not try to regulate intrastate consumers' rates, it can help create conditions under which State legislation can establish rate structures based upon an objective and administratively workable standard of the "prudent investment" in the properties rather than upon the grossly unfair and unreliable variables of "fair value" and "reproduction cost."

We accept the view expressed in the minority report of the New York Commission on Revision

of the Public Service Commissions Law that the decisions of the Supreme Court do not preclude State legislatures from working out a rate policy for the future, which, as to new properties and additions, will be based on the prudent investment in the properties. That has been the accepted policy in Massachusetts and California and was the policy adopted by Congress in the Federal Water Power Act. In the case of properties already dedicated to the utility industry at the time of the adoption of such a policy, the investor and consumer may have to accept "fair value," which, realistically, is nothing more than negotiated or arbitrated value. But in our judgment Congress and the States, within their respective jurisdictions, are free to determine once and for all the "fair value" of existing properties at a particular time and protect both the investor and consumer by providing a definite and predicable rate base for the future.

Substantial strides in this direction can be made now by Federal legislation which will control the accounts, security transactions, and investments of holding companies in relation to the actual prudent investment in the underlying utility properties. The ultimate effect of such legislation should be to encourage holding companies thus freed from excessive capital burdens to adopt a low-rate policy for their operating companies in their own interest. Lower rates and the greater and more economic use of gas and electricity by agricultural, domestic, and industrial consumers implied by lower rates are a necessity for the continued growth of a great in-

dustry and for the realization of its full possibilities.

Attempts by State commissions to protect the consumer from the burdens which holding-company practices have imposed upon him have been, and practically always must be, largely unsuccessful. The public-utility holding companies have become Nation-wide institutions. Their subsidiary operating companies are located in every State. Electric Bond & Share Co. has operating companies in 36 States and 8 other systems have units in 11 to 29 States. Many holding companies have affiliations, sometimes amounting to control, with banking interest, construction companies, coal mines, newspapers, and other interests. Their securities are widely marketed by use of the mails and the instrumentalities of interstate commerce to investors throughout the country. Holding-company operations are too extensive, State commission powers and funds too limited, to make thorough and effective State action possible. And usually the holding companies have purposely arranged their organization and operations to keep out of reach of State regulation; their lawyers have challenged the jurisdiction of such regulation. Generally a holding company itself is incorporated outside the States in which its operating companies are located and carefully does not do business within those States in a manner which will give State commissions technical power to reach the books and records of the holding company. Even if obtainable, however, such books and records will be comparatively unintelligible and even misleading until uniform accounting methods are made compulsory. There

is the further difficulty of allocating the appropriate proportion of the cost of holding-company activities to its subsidiaries in a particular State, coupled with needless waste in having the process duplicated in State after State. These difficulties of State agencies are so fundamental that not even interstate compacts—assuming they could be evolved—can make State regulation practically effective without supplemental help from a Federal law.

The only practical control over public-utility holding companies will be one which can directly reach the holding company itself and supervise its security structure and its use of capital and make possible over a period of time the elimination of the holding company where it serves no demonstrably useful and necessary purpose. Only in that way can Government protect the investors who supply that capital and the consumers who must bear its cost. The need of Federal control is no less imperative because all holding companies have not been guilty of all the abuses that have been indulged in under the holding form. The abuses have not been spasmodic only, but sufficiently widespread to necessitate legislation to protect the public against an inherently dangerous corporate device, which, unregulated, reflects unjustly on guilty and innocent alike.

We therefore recommend Federal legislation regarding public-utility holding companies. Such legislation should eradicate disclosed abuses, prevent the use of the holding company and affiliated interests to obstruct State regulation of operating companies, and make possible the elimination of the holding company where it serves no demon-

strably useful and necessary purpose, without undue dislocation of investment or the loss of operating economies which flow from economically and geographically integrated public-utility systems.

1. The ultimate purpose of the legislation should be the practical elimination within a reasonable time of the holding company where it serves no demonstrably useful and necessary purpose. But the amount of reorganization, transfers of assets, and distributions in dissolution required for the dismantling of our huge holding-company systems is so great that the task of elimination cannot be accomplished in a year or two without possibly too great sacrifice of apparent values. Furthermore, it seems administratively advisable that every opportunity be offered the owners of holding-company securities to work out their own processes of dismantling. That opportunity should, of course, be vigilantly guarded to protect the average investor from the exploitation threatening him almost as a matter of course under our usual methods and mores of corporate reorganization. In destroying the abuses of the holding companies, the Government must not leave great groups of helpless investors to the certain abuses of extensive hurried corporate reorganizations. The dominant groups who have ruthlessly plucked the investor in promoting some of these huge holding companies must not be allowed to pluck him again as reorganization managers.

On the other hand, if the disappearance of the holding-company excrescence is to be realistically expected at the end of a given period, there must

be a constant pressure on the managers of holding-company enterprises, persistent from the very beginning of that period, to insure a continual process of whittling down complicated capital structures and of disassociating operating properties not related to each other geographically or economically: Only such a continual process can guarantee that at the end of the given period the holding companies will have been dismantled into organizations simple enough in structure to be readily dissolved if they are to dissolve, or sufficiently shrunk and integrated for operating purposes so that they may readily be transformed into operating companies. Without such a dismantling process holding-company liquidation at the end of the period may well cost the same sacrifice of investors' interests as would be required to effect their liquidation a year from today. The devices recommended below are devices to effect that continual pressure to compel that continual dismantling process.

2. To attain the flexibility desirable for the handling of this complicated problem in a realistic and prudent way, Federal control should be vested in an administrative commission. Every holding company should be required to register with this commission if, either directly or through subsidiary companies, it employs the instrumentalities of interstate commerce to distribute securities, to transmit or transport electric energy or gas, to perform contracts, or to carry on any business. Furthermore, every holding company should be required to register if it has outstanding securities which were distributed to the public through the channels of interstate commerce, since

by such distribution it has set into motion forces which are still active and are Nation-wide in their effect upon both consumers and investors. At the time of registration, the companies should be required to file with the commission detailed information concerning their financial condition and operations, their security structure, their control over and relations with subsidiaries, and their affiliations with other interest of whatever kind. The definition of a holding company should be broad enough and flexible enough to reach every company which in fact controls public-utility companies, whether or not that control be dependent upon a specified security ownership. Federal registration provides the legal mechanism for controlling the activities of registered holding companies and their associate interests.

3. The issuance of new securities by holding companies should be adequately supervised by the commission so that in reorganizations and rearrangements of properties an uninformed investing public shall not have foisted upon it securities which are in no sense secure and carry little or no voice in management. Security issues should be limited to purposes necessary in the public interest, which accords with the ultimate purposes of the legislation; and each security issued should bear a proper relation to the capital of the company, its existing securities, the securities of the companies in a geographically and economically related system, and, above all, to the prudent investment in the properties of the issuer and its underlying companies. There should be an end to the pyramiding of holding-company securities.

Except for necessary discretionary power in the commission in the case of refunding issues, new securities should be limited to par value common stock, with appropriate voting rights, and to first-lien bonds, i. e., bonds having a first lien either on physical assets of the issuer or upon first-mortgage bonds of operating subsidiaries. In this as in almost every phase of the holding-company problem the ultimate interests of consumers and investors are identical. In a system burdened with overcapitalized and debt-ridden holding companies, the consumers of operating subsidiaries have to support the topheavy structure by paying high rates and by enduring poor service from inadequately maintained plants.

4. The commission should have complete control over the acquisition of new securities and properties by holding companies and others in holding-company systems in the course of reorganizations and rearrangements of properties. New acquisitions should not be allowed unless the applicant can clearly demonstrate a resultant economy and efficiency from the connection of naturally related and interdependent properties. The commission should have power to prevent acquisitions at prices which do not bear a proper relation to the capital prudently invested in the underlying utility properties, or if the acquisition would tend to create monopoly or restraint of trade in the exercise of control of public-utility companies.

5. Holding companies should be restricted as soon as practicable to the business of operating and of owning the securities of public-utility properties; they should not be permitted to engage in nonutility or speculative ventures. Elec-

tric utility and interstate gas transmission or production should be divorced from common control. Similarly, domestic and foreign utilities should be separated. Unless approval of a State commission be obtained, the commission should not permit use of the holding-company form to combine a gas and an electric utility serving the same territory where local law prohibits their combination in a single company.

6. Holding companies should immediately be prevented from borrowing from subholding companies or from operating companies in the same holding-company system. The commission should have power to prevent holding companies and their subsidiaries from paying dividends out of capital or unearned surplus, or from paying any dividend on a security or acquiring or retiring their own securities if such action would endanger the financial integrity of the system or impair the working capital of operating companies. The commission should have authority to prevent the sale of utility assets and securities at prices unfair to investors or in situations where separation of the properties would imperil the efficient interconnection of companies within the group.

7. All other loans and transactions within the systems and with affiliated interests, and the fees paid in connection with such transactions, should be carefully scrutinized and publicized. To prevent the continuing of present abuses and the sheltering of new ones in even subtler and more elusive forms of intercompany relationship than that of holding-company control, it will be necessary in handling intercompany transactions, carefully to define affiliations amounting to less than

control. In speaking of these relationships, the Federal Trade Commission has said:

> the inquiry early disclosed the fact that such companies (affiliates) were frequently used as vehicles whereby certain deals dictated by certain holding companies could be given the appearance of straightforward conservative business transactions, and whereby only a few company executives would know their true significance.

8. The holding company should immediately be required to divest itself of any interest in the business of issuing, underwriting, and creating new security issues for itself or controlled companies, and should not be allowed to derive fees or commissions from security transactions. The holding company in the role of banker is in dangerous conflict with the interests of its investors and consumers.

9. All service, sales, and construction contracts not performed by independent companies should be performed by companies or associations organized on a strictly mutual basis to insure the performance of their work at cost. The commission should have continuous supervision over these mutual organizations to require adequate reports, uniform accounts, the maintenance of equitable allocations of costs among the companies served and the assurance of efficient and economical operation. The commission should make a study and recommendations to State commissions and public utilities concerning the nature, costs, and economies of various kinds of services rendered to different types and sizes of utilities. The provisions

on service, sales, and construction contracts and those regarding other intercompany transactions should put an end to profits from intercompany transactions in a holding-company system. The returns of holding companies would be limited thereby to dividends from their holdings in economically and geographically integrated utility properties.

10. Holding companies should be required to make periodic and other reports concerning their own and their subsidiaries' financial condition and operations. Such reports should be based upon uniform methods of accounting prescribed by the commission, with due regard for the power of the States to prescribe the accounts of operating companies. The requirements concerning reports and accounts should extend to affiliates regarding their transactions with affiliated operating and holding companies. With uniform accounts available to the commission, to State commissions, and to the public, misleading and unsound accounting practices should lessen appreciably, and it should be possible to make intelligent comparisons of performances and to ascertain the investment behind holding-company securities.

11. The commission should study existing systems so that they may be simplified by the elimination of unnecessary corporate complexities and of properties which do not fit into an economically and geographically integrated whole. Simplification and reorganization of holding-company structures, making possible within a reasonable period the practical elimination of the holding company,

should be conducted under the Commission's supervision over a period of time to prevent undue losses to security holders from investment dislocations. Voluntary action by the companies should be encouraged as much as possible, but the commission should be empowered to issue orders compelling necessary divestments, dissolutions, and reorganizations. Such orders should be enforceable in the courts and the commission should act as trustee to effectuate necessary divestments, reorganizations, or dissolutions. The commission should have power to institute proceedings for the reorganization of holding companies under section 77B of the Bankruptcy Act, as amended, and to act as trustee in any proceeding concerning such companies under said section 77B, or receiver in any Federal equity receivership of such companies. No reorganization plan under the Bankruptcy Act, or otherwise, should be effective unless it has been prepared or approved by the commission. Solicitation of proxies, consents, or deposits in connection with a reorganization plan should be prohibited until after a hearing on the plan before the commission. Such solicitation should also be barred unless accompanied by such information regarding the plan, the commission's report thereon, and the interests of the persons sponsoring the plan as will inform the investor adequately of his rights and effect of the plan on his position.

12. The exemption, under the revenue act, for dividends received by corporate holding companies and affiliates on the securities of public-utility companies and other holding companies might

be partially removed. The increased tax occasioned by such a partial removal of this exemption might stimulate active cooperation by holding companies in eliminating intermediate corporate layers and will discourage the use of the holding company as a device for the control of electric and gas utilities except where its use will result in clearly demonstrable economies sufficient to compensate for the tax.

Respectfully submitted.

HAROLD L. ICKES,
Chairman.

FRANK R. MCNINCH,
ELWOOD MEAD,
T. W. NORCROSS,
MORRIS L. COOKE,
ROBERT E. HEALY,
DAVID E. LILIENTHAL,
EDWARD M. MAKKHAM.

Attest: JOEL DAVID WOLFSOHN,
Executive Secretary.

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FEB 23 1945

CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 81.

OTIS & CO.,

Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION and THE UNITED LIGHT AND POWER COMPANY,

Respondents.

PETITION FOR RE-HEARING.

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Securities and Exchange Commission and The United Light and Power Company,

Respondents.

Petition for Re-Hearing.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

The Petition of Otis & Co. respectfully represents:

1. Otis & Co. filed a Petition for Writ of Certiorari to the Circuit Court of Appeals for the Third Circuit in the above-captioned matter and on June 12, 1944 certiorari was granted. 322 U. S. 724. On January 29, 1945, opinions were filed and the judgment of the Court entered affirming the action of the Circuit Court. Your petitioner incorporates said opinions herein by reference. This Petition for Re-Hearing is filed within twenty-five days after the entry of the judgment.

2. The majority opinion filed in the above cause on January 29, 1945, states:

> "We have not undertaken to review the facts to determine whether the allocation of stock between the preferred and common is in proper proportion. That issue is not made."

Your petitioner respectfully prays that this Court grant a re-hearing for the purpose of undertaking to review the facts, which are not in dispute, to determine whether the allocation of stock between the preferred and common is in proper proportion, and as its grounds for making such request says:

A. The question presented to this Court was divided into two phases:

(1) Is the instant Plan "fair and equitable"?

Inherent in this question are the equities of the different classes of stock affected by the Plan and the allocation as between them based on undisputed facts. Petitioner's first Specification of Error challenges the Finding of the District Court on this point.

(2) Whether a "fair and equitable" Plan provides for the liquidation of the corporation and yet avoids maturing the liquidation preferences in the corporation's charter?

Petitioner's other Specifications of Error dealt with different aspects of this question.

We regard the question pertaining to the liquidation preferences as having been decided by the Court, and no application for re-hearing is made on that question, but

the Court did not undertake *to decide the question* of allocation.

It is clear, of course, that the ultimate answer which is necessary is the answer to the question of allocation. It is obvious that an answer to a subsidiary question, no matter how important that subsidiary question may be, is not fully determinative of the matters involved.

It is certainly true that Petitioner relied heavily upon the theory that liquidation did mature preferences and that the charter provisions governed, but as is shown in the next succeeding paragraph, it was intended to raise the issue of "fair and equitable" in all of its phases.

B. Petitioner intended to make such issue and considered it had done so by incorporating the dissenting opinion of Commissioner Healy. In presenting its Petition for Writ of Certiorari, petitioner included the question, "Is the instant Plan 'fair and equitable' within the meaning of that phrase as used in Sec. 11 (e) of the Act?" (Brief, p. 8). In its Brief in support of the Petition for Writ of Certiorari petitioner adopted and incorporated the dissenting opinion of Commissioner Healy (Brief in Support of Petition, p. 19), and specifically challenged the allocation as being unfair and inequitable (Brief in Support of Petition, pp. 25-26). In the Brief filed by petitioner after certiorari was granted petitioner again adopted and referred this Court to the dissenting opinion of Commissioner Healy (Brief, p. 28). Petitioner considered that by adopting the view of Commissioner Healy it did make the issue of whether the allocation was in proper proportion. Petitioner adopted that method in the court below, and Judge Biggs pointed out that by incorporating and asserting the view of Commissioner Healy the issue with respect to the allocation *was* made, and the Circuit Court accordingly considered the matter (R. 126-127; 142 F. 2d 411, at p. 414).

C. The dissenting opinion of Commissioner Healy, incorporated herein by reference, reviews the facts, which are not in dispute, and demonstrates that the allocation of stock between the preferred and common is not in proper proportion, even though the arrearages are not matured by the Plan. [redacted] (R. 48-77). Commissioner Healy concluded that, "* * * the common's investment in Power was lost years ago, before the passage of the Holding Company Act" (R. 76). In its opinion herein this Court said:

> "The Commission found the balance sheet value of all Railways' common on a pro forma corporate basis to be $77,954,874 and, when using a pro forma consolidated basis for the entire system, to be $81,554,330. On a capitalization of reasonably anticipated earnings of the system, the Commission was unable to find a value for Railways' common 'which approaches $98,700,000.00.'"*

D. This Court should review the questions involved in the making of the allocation between the preferred and common stockholders under the Plan submitted under Sec. 11 (d) of the Public Utility Holding Company Act of 1935 to comply with the requirements of Sec. 11 (b) of the Act because of the importance of such questions in the administration of the Act. At present, there are pending before the Commission plans to comply with Sec. 11 (b) of the Act involving allocations between preferred and common stockholders of at least 58 companies with preferred securities involved having a par value of over

* The present market value of the common stock of United Light and Railways Company (based on current sales on a when issued basis) is less than $51,000,000. This Railways' stock is the only asset being allocated to the security holders of United Light and Power Company.

$2,300,000,000) and accumulated arrearages in excess of $700,000,000) plus several others now under judicial review. (See Appendix annexed hereto.) Some of such securities were issued after the passage of the Act.

E. The review sought is not a review of a factual determination by an administrative agency, but instead a review in equity of a final order entered by the District Court for the District of Delaware. Although the Commission found the Plan fair and equitable, the proceedings below were not proceedings brought to review an Order of the Commission under Section 24 of the Act, but instead, the proceedings were instituted by the Commission under Sec. 11 (e) of the Act,* which, in effect, authorizes the Commission to institute original proceedings in a District Court to have a *de novo* determination by the District Court that the Plan is fair and equitable. The text of Sec. 11 (e) clearly indicates that the Federal District Courts are intended to consider the merits of plans as a condition to the entry of orders enforcing them. The District Court to which the plan is brought for enforcement *must make findings* substantially identical with those required to be made by the Commission. The appeal to the Circuit Court of Appeals was from the decision of the District Court (R. 1, 125-126) and not from the Findings or Opinion or Order of the Commission. The certiorari granted by this Court was to review the action of the Circuit Court of Appeals in affirming the Order of the District Court, and hence the certiorari which brought up the Record before the Circuit Court of Appeals brought up for review in this Court the action of the District Court taken upon the Complaint filed in that Court by the Commission.

* See Appendix to Petitioner's Brief, p. 33.

It is respectfully submitted that in the interests of justice to the preferred stockholders of United Light and Power Company and to the general investing public a rehearing should be granted, and the matter of allocation finally determined.

Dated: February 23, 1945.

Respectfully submitted,

OTIS & CO.,
Petitioner,

By ARTHUR G. LOGAN,
Continental American Building,
Wilmington 33, Delaware,
Its Attorney.

RICHARD B. HAND,
111 Broadway,
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ROBERT J. BULKLEY,
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Of Counsel.

CERTIFICATE OF COUNSEL.

I hereby certify as counsel for Otis & Co. that the foregoing Petition for Re-Hearing is presented in good faith and not for delay.

ROBERT J. BULKLEY,
Bulkley Building,
Cleveland 15, Ohio.

City of Washington,
District of Columbia —ss.:

BE IT REMEMBERED, that on this 23rd day of February, A. D. 1945, personally appeared before me, the subscriber, a Notary Public for the District of Columbia aforesaid, ROBERT J. BULKLEY, who, being by me first qualified according to law, did depose and say that he is the attorney for the petitioner named in the foregoing Petition; that he has read the foregoing Petition and that the facts set forth therein are true so far as the same relate to his own acts and deeds, and so far as the same relate to the acts and deeds of any other person or persons, he believes them to be true.

ROBERT J. BULKLEY.

Sworn to and subscribed before me the day and year first aforesaid.

JANE DODGE,
Notary Public.

APPENDIX A

Outstanding Preferred Stocks of Public Utility Holding or Operating Companies Which Are Involved in Pending Section 11 Proceedings Pending before the Securities and Exchange

System Company	Title of Issue
American States Utilities Corporation	5½% Cum., $25 par
American Utilities Service Corporation	6% Cum., $25 par
American Water Works and Electric Co., Inc.	$6 Cum., 1st Pfd., no par
West Penn Electric Co.	7% Cum., $100 par
	6% Cum., $100 par
	$7 Cum., Class A, no par
	$7 Non-Cum., Class B, no par
Associated Gas and Electric Company	
General Gas & Electric Corp.	$7 Cum., pfdst., no par
	$6 Cum., conv., Series A, no par
	$6 Cum., conv., Series B, no par
	$7 Cum., no par
	$7 Cum., Class B, no par
	$8 Cum., no par
Tide Water Power Company	$6 Cum., no par
NY PA NJ Utilities Company	$3 Non-cum., no par
Central Public Utility Corporation	$4 Non-cum., partic., no par
	Class A Common, $1.75 partic.
Consolidated Electric & Gas Company	$7 Cum., no par
	Class A partic., non-cum., $1 par
Cities Service Co.	$6 Cum., no par
	6% Cum., preference B, no par
	$6 Cum., preference BB, no par
Federal Light & Traction Co.	$6 Cum., no par
Columbia Gas & Electric Corporation	6% Cum., "A" $100 par
	5% Cum., $100 par
	5% Cum., preference, $100 par
Commonwealth & Southern Corporation, The	6% Cum., no par
Eastern Minnesota Power Corporation	$6 Cum., no par
Wisconsin Hydro Electric Co.	6% Cum., $100 par
Electric Bond and Share Co.	$6 Cum., no par
	$5 Cum., no par
American & Foreign Power Company, Inc.	$7 Cum., no par
	$6 Cum., no par
	$7 Cum., second pfd., Series A, no par

	Title of Issue	Involuntary Liquidating Value
& Electric Company	4½% Cum., $100 par	$ 35,562,300
Power & Light Company	$6 Cum., no par	79,378,100
	$7 Cum., no par	97,844,400
nesota Power & Light Company	7% Cum., $100 par	7,979,400
	$6 Cum., no par	7,958,200
Power & Light Corporation	$7 Cum., no par	51,416,200
	$6 Cum., no par	25,543,000
	$7 Cum., second pfd., no par	7,481,400
Public Service Co.	$5 Cum., no par	15,000,100
	$6 Cum., no par	6,586,800
	$5.50 Cum., no par	19,204,600
ter and Gas Corporation		
rk Water Service Corporation	6% Cum., par $100	4,653,200
vania Water Service Co.	$6 Cum., no par	112,500
Water and Gas	$6 Cum., no par	699,700
n Spring Brook Water Service Co.	$6 Cum., no par	3,781,900
	$7 Cum., no par	1,207,500
l Hydro-Electric System	$3.50 Cum. conv., $50 par	7,121,200
	$2 Cum., partic. Class A, par $25	51,403,080
gland Power Association	6% Cum., $100 par	65,645,700
	$2 Cum., no par	646,202
ssachusetts Power and Light Assoc.	$2 Cum., no par	63,556,700
	$2 Cum., second pfd., no par	14,875,100
North Boston Lighting Properties	6% Cum., $50 par	11,404,013
ssachusetts Utilities Associates	5% Cum. conv. partic. pfd.	34,745,400
de Island Public Service Company	$2 Cum., $27.50 par	16,358,958
	$1 Cum. partic., Class A com., $55 par	8,073,500
s Corporation		
n Public Service Co.	7% Cum., $100 par	8,772,000
& Southwest Utilities Co.	$7 Cum. prior lien, no par	11,740,000
	$6 Cum. prior lien, no par	1,150,000
	$7 Cum., no par	13,315,000
West Utilities Co.	7% Cum., prior lien, $100 par	4,400,000
	7% Cum., $100 par	6,075,500
	$6 Cum., $100 par	2,400,000
nited Company		
Service Corporation	7% Cum., Class A $100 par	1,370,000
	6% " $100 par	1,962,200
d Public Service Co.	$7 Cum. prior lien, no par	11,874,700
	$6 " " " "	6,000,000
	$7 Cum., no par	4,805,900
	$6 " "	10,713,900
	Adjustment, no par	35,300
	$6 Cum. conv., no par	255,500

System Company	Title of Issue	Involuntary Liquidating Value
North American Co., The	6% Sec. Cum. $50 par	$ 30,317,950
	5½% Sec. Cum. $50 par	24,859,600
	Sec. Cum., no par	19,418,400
North American Light & Power Co.	5% Cum. conv. $50 par	24,175,900
Illinois Power Co.	7% Cum. $100 par	8,500,000
Washington Railway & Electric Co.	6% Cum. $100 par	8,234,500
Mississippi River Power Co.		
North Continent Utilities Corporation	$7 Non-cum. conv. no par	4,380,940
Northern States Power Co. (Del.)	7% Cum. $100 par	39,107,700
	6% Cum. $100 par	39,104,900
Ogden Corporation		
Central States Utilities Corporation	$7 Cum., no par	3,200,000
Central States Power & Light Corporation	$7 Cum., no par	8,000,000
Interstate Power Company (Del.)	$7 Cum., no par	7,250,000
" " "	$6 Cum., no par	4,750,000
Peoples Light and Power Company	$2 Cum. conv. $25 par	4,160,050
Republic Service Corporation	$6 Cum., no par	1,758,100
Standard Power and Light Corporation	$7 Cum., no par	3,405,400
Louisville Gas & Electric Company (Del.)	Class A Common no par	15,069,250
United Corporation	$3 Cum. preferred no par	65,299,910
Buffalo, Niagara & Eastern Power Corp.	$5 Cum. 1st Preferred no par	35,000,000
" " "	$1.60 Cum., $25 par	59,418,125
Niagara Hudson Power Corp.	5% Cum. 1st Preferred, $100 par	37,887,500
" " "	5% Cum. 2nd Preferred, A, $100 par	9,028,100
" " "	5% Cum. 2nd Preferred, B, $100 par	1,564,900
United Light and Power Company	7% Cum. prior preferred, 1st ser. $100 par	3,799,300
United Light and Railways Company	6.36% Cum. prior preferred, $100 par	5,282,900
" " " " "	6% Cum. prior preferred, $100 par	951,600
" " " " "	6% Cum., $25 par	13,408,100
American Light & Traction Company	7% Cum. prior preference $100 par	20,743,000
Continental Gas & Electric Corporation	$3 Cum., no par	3,972,050
United Public Utilities Corporation	$2.75 Cum. no par	3,473,950
" " "		
Total		$2,322,352,518

(As of June 30, 1944.

Preferred Stocks of Public Utility Holding or Operating Companies Concerning Which Section 11 Plans are Pending in the Courts

Company	Class of Issue	Involuntary Liquidating Value
Capital Company	$7.00 Cum. Conv. Ser. A, No Par	$ 10,346,100
	$6.00 Ser. E, No Par	14,409,500
Utilities Company	6% Cum. Prior Lien, $100 Par	8,905,000
	7% Cum. Prior Lien, $100 Par	12,178,500
" "	7% Cum. Class A, $100 Par	11,340,100
	6% Cum. Class A, $100 Par	3,522,500
Corporation		
Gas Light Company, The	5% Cum. $100 Par	2,333,000
Electric Power Company	7% Cum. Prior Pref., $100 Par	5,682,400
	6% Cum. 1st Preferred, $100 Par	6,198,300
	7.2% Cum. 1st Pref., $100 Par	3,655,820
	$6 Cum. 1st Preferred, No Par	3,254,200
	$6 Non-Cum., 2nd Pref., $1 Par	358,600
Gas & Electric Company	$7 Cum. Prior Preference, No Par	36,854,800
	$6 Cum. Prior Preference, No Par	10,000,000
	$4 Cum., No Par	37,872,100
Colorado Power Company	7% Cum. $100 Par	1,251,600
	Common, Class A, Par $25	3,025,000
Total		$176,342,120

SUPREME COURT OF THE UNITED STATES.

No. 81.—October Term, 1944.

Otis & Co., Petitioner, *vs.* Securities and Exchange Commission and the United Light and Power Company.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[January 29, 1945.]

Mr. Justice Reed delivered the opinion of the Court.

An important although narrow legal point in the interpretation of the Public Utility Holding Company Act of 1935[1] is involved in this case. This is whether a plan under section 11(e) of that act may be "fair and equitable" to preferred stockholders within the meaning of those words as used in that section, which allows a participation by junior common stockholders in the distribution of the assets of a registered holding company, which is liquidated in compliance with section 11(b)(2), before the senior preferred stockholders receive securities whose present value equals the preferred's full liquidation preferences.

The Securities and Exchange Commission approved the Plan, Holding Company Act Release No. 4215, April 5, 1943. The United States District Court of Delaware approved the Plan, 51 F. Supp. 217, and the Circuit Court of Appeals affirmed this action. This Court has jurisdiction under Judicial Code, Section 240 and Section 25 of the Holding Company Act. Certiorari was granted because of the importance of the question raised in administration of the act. 322 U. S. 724.

The United Light and Power Company, a Maryland corporation, is a registered holding company under the Act. Section 5. It is the top holding company of a large system with twenty-four other corporate associates. Section 2a(10). Its place in the system violates the prohibition of the Act against a registered holding company being a "holding company with respect to [any] of its subsidiary companies, Sec. 2a(8), which itself has a sub-

[1] 49 Stat. 803.

sidiary company which is a holding company." Section 11(b)(2). This prohibition is known as the "great-grandfather clause."

In proceedings for the simplification of the system, after finding that Power violated the great-grandfather clause, an order was entered on March 20, 1941, directing that Power be liquidated and dissolved.[2] The order authorized Power to submit to the Commission a plan for compliance with the order "on a basis which is fair and equitable to its security holders." Power with its registered holding company subsidiary, The United Light and Railways Company, a Delaware corporation, all of whose common stock was owned by Power, submitted such a plan and after examination by the Commission and modification it was approved by order of April 6, 1943. The Plan was held specifically to be fair and equitable to all security holders. By the application and order Railways' participation in the Plan was accepted. Holding Company Act Release No. 4215. This is the order which is before us.

It approved the Plan for the liquidation and dissolution of Power as "necessary to effectuate the provisions of Section 11(b) of the" Act.[3] It directed counsel for the Commission to apply to an appropriate federal court for an order enforcing the Plan.[4]

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[2] The findings and opinion which led to this order are found in In the Matter of The United Light and Power Company, 8 S. E. C. 837.

[3] "It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

. . . . . .

"(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. . . ." 49 Stat. 820-21, sec. 11(b)(2).

[4] "(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of

The central feature of the Plan and the one here in issue was Power's proposed distribution of its assets to its preferred and common stockholders. Power's chief asset was its holdings of common stock in its subsidiary, Railways. It represented over $72,000,000 of its total gross assets of a little more than $81,000,000. All other property of Power which remained after the satisfaction of its obligations was to be distributed by Power to Railways. Thus this residual property of Power would inure to the benefit of Railways' new common stockholders, the former stockholders of Power.

Distribution of Power's common stock holdings in Railways was to be effected on the basis of 5 shares of Railways' common stock for one share of Power's preferred and one share of Railways' common for 20 shares of Power's common, an allocation of 94.52% to Power's preferred stockholders and 5.48% to Power's common stockholders. As Railways was the only company in the tier below Power of the holding company system, it would become by the dissolution of Power the top holding company and Power's preferred and common stockholders, by the distribution to them of all of Railways' common would have in the aggregate the same rights in Railways and in the holding company system that Power had. The rights and preferences of Power's stockholders would of course disappear with the distribution of Railways' common and the dissolution of Power. As holders of Railways' single class of common, a new relationship of equality would arise between Power's preferred and common stockholders.

This order was preceded by an examination by the Commission into the situation of this holding company system.[5] For a

subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed." 49 Stat. 822, sec. 11(e).

[5] The details are fully covered in 8 S. E. C. 837 and Application 14, Release No. 4215.

clear understanding of the single issue as to whether, in the liquidation of a holding company by order of the Commission under section 11(e), a participation by junior security holders in the assets is permissible before preferred security holders have received the entire liquidating preference secured to them by the company's charter, it is sufficient to state only the following facts about which there is no controversy between the litigants. Power is a solvent company. As of April 30, 1942, and there is no intimation that its condition has worsened, its balance sheet showed assets of $81,159,075 and liabilities of only $6,132,976, without consideration of its capital stock structure. Its principal asset, the Railways common stock heretofore referred to, has a book value in excess of the $72,000,000 plus at which it is carried on Power's balance sheet and an actual value which makes Power unquestionably solvent with large equity values in its stock.

Power has outstanding 600,000 shares of Class A Preferred. This preferred stock has a liquidation value of $100 per share or $60,000,000, plus arrearages of $38,700,000 as of December 31, 1942, or a total liquidating value ahead of the common, as of the time of the order of $98,700,000.[6] There are 2,421,192 shares of Class A common and 1,055,576 shares of Class B common.[7]

The Commission found the balance sheet value of all Railways' common on a pro forma corporate basis to be $77,954,874 and, when using a pro forma consolidated basis for the entire system, to be $81,554,330. On a capitalization of reasonably anticipated earnings of the system, the Commission was unable to find a

[6] Power's charter provides: "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the Class A Preferred stock shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of such stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned), including the full dividend for the then current quarterly period, before any payment is made to the holders of any stock other than the Class A Preferred stock. Any assets thereafter remaining shall be distributable among holders of stock other than the Class A Preferred stock in accordance with their rights at the time of the distribution."

The amended charter (1929) also contains the following:

"The Common Stock of the Company shall be subject to the rights of the holders of the Class A Preferred stock."

[7] The two classes are entitled to the same rights, except the B has votes. As there is no dispute before us as to the relative rights or priorities of the common, the two classes will be treated in this opinion as a single class of common.

value for Railways' common "which approaches $98,700,000.00."[8] If the liquidation preference of Power's preferred stock is applicable, under the Commission's conclusions on present valuations all of the Railways' common would go on distribution to Power's preferred. The Commission determined that the liquidation preference was not applicable and for these reasons.

The Commission's order of March 20, 1941, for the liquidation and dissolution of Power was a step in the simplification of the holding company system which simplification was enjoined by section 11(b)(2) of the Act. Satisfaction of the great-grandfather clause might have been obtained in this or other holding company systems by an order for merger, consolidation or recapitalization between top holding companies or between associate companies in the lower tiers of the corporate hierarchy. Such procedure would avoid the liquidation of Power. Cf. *Windhurst* v. *Central Leather Co.*, 105 N. J. Eq. 621; *Porges* v. *Vadsco Sales Corporation*, 32 A 2d 148, 151. The selection by the Commission of one method of system adjustment to accomplish simplification rather than another is an incident which ought not to affect rights. The exercise of legislative power by Congress through section 11(b)(2) to accomplish simplification as a matter of public policy and the Commission's administration of the Act by dissolution of this particular company results in a type of liquidation which is entirely distinct from the "liquidation of the corporation, whether voluntary or involuntary" envisaged by the charter provisions of Power for preferences to the senior stock.[9]

This conclusion permitted the Commission to examine the investment values of the common and preferred stocks of Power. The rights of the preferred stock to $6 annual cumulative

[8] "In order to show a value of as much as $98,700,000, it would be necessary to capitalize 1942 consolidated net earnings applicable to the common stock of Railways (the highest earnings since 1931) at a rate of 6.9%, a times-earnings ratio of 14.5. Even if the most liberal estimate of earnings made by the management, in the amount of $7,000,000, be taken as the measure of prospective earning power, capitalization of such earnings at a rate producing a times-earnings ratio of 14.1 is necessary to reach an over-all value of $98,700,000." Release No. 4215, pp. 7-8.

The Commission illustrated the market valuation by times-earnings ratio by pointing out that for nine representative public utility holding companies it had averaged from a high of 12.5 in 1937 to a low of 5.1 in 1942 with 1943 at 7.1. *Id.*

[9] Release No. 4215, pp. 9-12.

dividends in the going business[10] and to full priority in liquidation other than by operation of the Act were treated as factors in valuation rather than determinative of amounts payable in a traditional dissolution. Upon analysis of the Holding Company System's experience and upon an estimate of future earnings, the Commission assumed earnings of $6,185,000 annually which would be applicable to Railways' common and, as a consequence of the distribution, to Power's preferred and common stockholders. Since the annual preferred dividend requirements were $3,600,000, there appeared a balance of $2,585,000 available for the reduction of preferred stock arrearages of $38,700,000 as of December 31, 1942. The Commission noted that if all the assumed earnings materialized and were applied to liquidating the preferred current and deferred dividends, in approximately fifteen years the arrearages would be paid and the common would be in a position to receive dividends.[11] Furthermore, only by forced liquidation could the common stock be deprived of its possibility for future earnings. Only by means of forced liquidation and the receipt of all Railways' common, could Power's preferred gain a right to prospective earnings above its guaranteed dividends. The deferred dividends do not bear interest. While recognizing that the common stock participation was remote, the Commission determined that in its "overall judgment" Power's common had a legitimate investment value of a proportion of 5.48 per cent of Power's assets to the preferred's value of 94.52 per cent. Such a conclusion is not "susceptible of mathematical demonstration,"[12] any more than any other valuation of a utility's worth. The Commission determined this allocation was fair and equitable within section 11(e).

Petitioner does not challenge the above allocation of values between the preferred and common stock of Power, if the Commission is correct in treating the stock rights as though in a continuing enterprise instead of in liquidation. Petitioner relies upon the charter rights which on liquidation of Power give to the preferred $100 and the cumulated and accrued dividends. Note 6, *supra*. It relies upon the authorities of this and other courts which hold that under a full priority rule junior securities

[10] 8 S. E. C. 842.

[11] Release No. 4215, p. 18.

[12] *Id.*, p. 19.

in bankruptcy or equity reorganizations may not participate in the assets until the rights of the holders of senior securities are satisfied in full.[13] Petitioner says:

"When the Plan, whatever the device used, contemplates the surrender of outstanding securities for new securities, either in the same or a different company, it is not 'fair and equitable' to force senior security holders to accept less than that which they are contractually entitled to receive."

To petitioner, no distinction is to be drawn between liquidation under bankruptcy or reorganization and liquidation under the Public Utility Holding Company Act by virtue of sections 11(b)(2) and 11(e).

We reach the conclusion that the Securities and Exchange Commission applied the correct rule of law as to the rights of the stockholders inter sese. That is to say, when the Commission proceeds in the simplification of a holding company system, the rights of stockholders of a solvent company which is ordered by the Commission to distribute its assets among its stockholders may be evaluated on the basis of a going business and not as though a liquidation were taking place.

The manifest solvency of Power simplifies the problem of stockholders' rights with which we are here concerned. The creditors are satisfied.[14] No possibility exists that simplification of structure is employed here to evade or nullify creditors' rights in reorganization or to take the place of traditional reorganization.[15]

Like the bankruptcy and reorganization statutes, the Public Utility Holding Company Act, in providing that plans for simplification be "fair and equitable", incorporates the principle

[13] Northern Pacific Railway Co. v. Boyd, 228 U. S. 482; Case v. Los Angeles Lumber Products Co., 308 U. S. 106; Consolidated Rock Products Co. v. du Bois, 312 U. S. 510; Marine Properties v. Trust Co., 317 U. S. 78; Ecker v. Western Pacific R. Corp., 318 U. S. 448; Group of Investors v. Milwaukee R. Co., 318 U. S. 523.

[14] Creditors' contracts also have been declared subject to equitable adjustment in corporate reorganizations so long as they receive "full compensatory treatment" whether the reorganization is in bankruptcy (Kansas City Ry. v. Cent. Union Tr. Co., 271 U. S. 445, 455; Consolidated Rock Products Co. v. du Bois, 312 U. S. 510, 528-30; Group of Investors v. Milwaukee R. Co., 318 U. S. 523, 565-66) or in compliance with regulatory statutes. Continental Co. v. United States, 259 U. S. 156, 170-76. The full priority rule applies to reorganizations of solvent companies. Consolidated Rock Products Co. v. du Bois, 312 U. S. 510, 527.

[15] See In the Matter of Jacksonville Gas Company, Holding Company Act Release No. 3570, In re Jacksonville Gas Co., 46 F. Supp. 852, 856.

of full priority in the treatment to be accorded various classes of security interests. This right to priority in assets which exists between creditors and stockholders, exists also between various classes of stockholders. When by contract as evidenced by charter provisions one class of stockholders is superior to another in its claim against earnings or assets that superior position must be recognized by courts or agencies which deal with the earnings or assets of such a company. Fairness and equity require this conclusion. Even before our decision in *Case* v. *Los Angeles Lumber Products Co.* on November 6, 1939, recent federal cases had recognized this priority.[16] That has been their view since the *Case* decision, *In re Porto Rican American Tobacco Co.*, 112 F. 2d 655, 656-57. This is the rule applied by the Commission in the simplification of corporate structure. The Commission recognizes and applies the doctrine of full priority by giving value to the rights of the preferred in a going concern rather than as if by sale and distribution. Its views are stated below.[17] The issue in this case is not whether full priority should be given to preferred over common stockholders but whether the priority which is established by the charter, note 6.

[16] In re New York Railways, 82 F. 2d 739, 743-44; In re National Food Products Corp., 23 F. Supp. 979, 985; In re Utilities Power & Light Corp., 29 F. Supp. 763, 769.

[17] "It is pointed out in Commissioner Healy's separate opinion that the words 'fair and equitable' embodied in Section 11 have a settled meaning, as determined by the courts, and that an application of the 'absolute priorities' doctrine must result in no distribution to Power's common stock in this case. But that is because he measures the rights of the preferred stock as they would be measured in bankruptcy cases, and not merely because he follows the 'absolute priorities' doctrine in determining the consequences of the measurement. In other words, we can agree with him when he says that absolute priorities must be respected, because we think that doctrine simply means that the common stock must not be accorded any participation unless the preferred stock has been fully compensated for its rights and priorities. But there the area of agreement stops, because he says further that the rights and priorities of the preferred stockholders are the same here as in bankruptcy cases, where their claims to liquidation preferences (including dividend arrearages) are treated as matured. In our view it would be unconscionable and contrary to the plain intention of Congress to so hold." Holding Company Act Release No. 4215, p. 12.

"Under the circumstances, fair and equitable compensation will be given to all of the claimants if their rights are measured not in terms of the situation created by the statute but rather in terms of the situation terminated by it—i. e., as though no liquidation were to take place. In this way each class of stock will be accorded its proportionate share of the benefits to be gained from the elimination of a useless and expensive corporate entity and from the receipt of a security representing a more direct investment in the underlying assets and earnings of the system." *Id.*, p. 13.

is applicable to a simplification by liquidation under § 11(b)(2) and (e). There is an argument that if the charter provision applies to this situation, it cannot be disregarded and that in such a liquidation "fair and equitable" would require the distribution of assets only to the preferred. We do not reach that question. The point at issue is whether this charter provision applies.

The applicability of the charter provision under the Public Utility Holding Company Act of 1935 is a matter of federal law.[18]

When the President sent to Congress the report of the National Power Policy Committee which placed the suggestions of the Executive on holding companies before the legislative body, he said of the pending Public Utility Holding Company bill:

"Such a measure will not destroy legitimate business or wholesome and productive investment. It will not destroy a penny of actual value of those operating properties which holding companies now control and which holding company securities represent insofar as they have any value. On the contrary, it will surround the necessary reorganization of the holding company with safeguards which will in fact protect the investor." S. Rep. No. 621, 74th Cong., 1st sess., p. 2.

That report urged the same care to investors:

"Simplification and reorganization of holding-company structures, making possible within a reasonable period the practical elimination of the holding company, should be conducted under the Commission's supervision over a period of time to prevent undue losses to security holders from investment dislocations." *Id.*, p. 60.

Of course, Congress would wish, in simplifying a holding company system capital structure, to preserve values to investors, not to destroy them.[19] Consequently, while giving the Commission power to compel the elimination of holding companies, deemed uneconomic, it allowed the affected companies to propose plans to the Commission to effectuate the objects and the Commission to

[18] Jerome *v.* United States, 318 U. S. 101, 104; Wragg *v.* Federal Land Bank, 317 U. S. 325, 328; Chicago Board of Trade *v.* Johnson, 264 U. S. 1, 10; Sola Electric Co. *v.* Jefferson Co., 317 U. S. 173, 176; N. L. R. B. *v.* Hearst Publications, 322 U. S. 111, 120, 129; Clearfield Trust Co. *v.* United States, 318 U. S. 363, 366; O'Brien *v.* Western Union Telegraph Co., 113 F. 2d 539, 541.

[19] "Such disposition as may be necessary can be accomplished by reorganization which will equitably redistribute securities among existing security holders." S. Rep. No. 621, 74th Cong., 1st Sess., p. 16; H. Rep. No. 1318, 74th Cong., 1st Sess. pp. 49-50.

approve such plans when they were considered "fair and equitable." Sections 11(b)(2) and (e), notes 3 and 4.

It may be that if the charter liquidation preference were held to cover this situation it would not frustrate the simplification of the holding company system, to the same degree that the gold clause agreements interfered with the power of Congress to regulate the gold content of the dollar. *Norman* v. *B. & O. R. Co.*, 294 U. S. 240, 306, *et seq.*, and cases cited. Distribution to preferred stockholders only with disregard of common's interest would eliminate Power and cure the system's present inconsistency with the great-grandfather clause. We think, however, the charter preference is inoperative in simplification under section 11(b)(2). The provision having been adopted in 1929, six years prior to enactment of the Public Utility Holding Company Act, a "simplification" under this Act, having as an incident to it the dissolution of one company in a holding company system, was not an anticipated "liquidation" within the meaning of Power's charter provision. Enforcement of an overriding public policy should not have its effect visited on one class with a corresponding windfall to another class of security holders. Nor should common stock values be made to depend on whether the Commission, in enforcing compliance with the Act, resorts to dissolution of a particular company in the holding company system, or resorts instead to the devices of merger or consolidation, which would not run afoul of a charter provision formulated years before adoption of the Act in question. The Commission in its enforcement of the policies of the Act should not be hampered in its determination of the proper type of holding company structure by considerations of avoidance of harsh effects on various stock interests which might result from enforcement of charter provisions of doubtful applicability to the procedures undertaken. Where pre-existing contract provisions exist which produce results at variance with a legislative policy which was not foreseeable at the time the contract was made, they cannot be permitted to operate. Compare *New York Trust Co.* v. *Securities and Exchange Com.*, 131 F. 2d 274; *In re The Laclede Gas Light Company*, (E. Mo. D. C., Aug. 25, 1944). The reason does not lie in the fact that the business of Power continues in another form. That is true of bankruptcy and equity reorganization. It lies in the fact that Congress did not intend that its exercise of power to simplify

should mature rights, created without regard to the possibility of simplification of system structure, which otherwise would only arise by voluntary action of stockholders or, involuntarily, through action of creditors. We must assume that Congress intended to exercise its power with the least possible harm to citizens.

But it is said that such a conclusion is at variance with this Court's ruling in *Continental Co.* v. *United States*, 259 U. S. 156. In that case a liquidation of the Reading Company, a holder of interests in railroads and coal mines, was compelled by governmental prosecution so that it would not be operating in violation of the Sherman Anti-Trust Act or the Hepburn Act.[20] Its coal properties, corporate assets, were passed to a newly organized coal company, the value of whose stock, by negotiable certificates of interest, came into possession of Reading's old stockholders individually. The distribution gave equal participation in the coal properties to the common and preferred stock in accordance with the charter agreement as to assets on liquidation, pages 177-181. The common stock contended that as the value of the coal properties was surplus, all of the coal certificates should go to the common stockholders as in a continuing business. Thus, by its approval of the distribution, this Court handled the liquidation, which was forced by law, says petitioner, in accordance with the charter provisions and not as though it were a continuing business.

The *Continental* or *Reading* case turned, however, on the charter rights of the preferred to share equally with the common in earnings which had become assets, pages 179-80, not on whether a right to share was matured or varied by governmental action. Contrary to the situation in this present case, the charter provisions of the Reading Company were adopted with knowledge of the sanctions of the Sherman Act against monopoly. 259 U. S. 177 and 171. We do not feel constrained by its dealing with charter rights as in a normal liquidation to hold that where liquidation is adopted as a matter of administrative routine, the preferences are thereby matured.

As indicated earlier in this opinion, we have not undertaken to review the facts to determine whether the allocation of stock between the preferred and common is in proper proportion. That issue is not made. It was vigorously discussed by Commissioner Healey in the dissenting opinion. Holding Company Act Release

[20] 259 U. S. 156 at 177; United States v. Reading Co., 253 U. S. 26; 26 Stat. 209; 34 Stat. 584.

4215, p. 39 *et seq.* See Dodd, Holding Company Act Recapitalizations, 57 Harv. L. Rev. 295, 319. The allocation properly may be made without dollar valuation so long as "each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered." *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523, 565; *Consolidated Rock Products Co.* v. *du Bois*, 312 U. S. 510, 529-30; *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 482; *Kansas City Ry.* v. *Cent. Union Tr. Co.*, 271 U. S. 445, 455.

As the parties have not challenged them, we have not considered in any way the constitutionality of the sections of the Holding Company Act involved.

Affirmed.

Mr. Justice DOUGLAS took no part in the consideration or decision of this case.

Mr. Chief Justice STONE, dissenting.

Mr. Justice ROBERTS, Mr. Justice FRANKFURTER and I think the judgment below should be reversed.

The United Light and Power Company, the subject of this litigation, is a holding company subject to provisions of the Public Utility Holding Company Act of August 26, 1935, 49 Stat. 803. It has $60,000,000 par value of Class A preferred stock, of which petitioner holds some shares, and two classes of common stock. The corporate charter provides:

"Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the Class A Preferred Stock shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of such stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned), including the full dividend for the then current quarterly period, before any payment is made to the holders of any stock other than the Class A Preferred stock."

The dividends on the preferred stock accrued and unpaid amount to $64.50 per share, and the total priority of the preferred stock as provided by the corporate charter is $98,700,000.

Sections 1(c) and 11(a) and (b)(2) of the Act authorize the Commission, after an examination of their corporate structures, "to compel the simplification of public-utility holding-company systems" and to require any such holding company "to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company". Section 11(e) requires any plan of reorganization approved by the Commission to be "fair and equitable to the persons affected by such plan".

Acting under these provisions of § 11 the Commission has ordered that United be "liquidated and dissolved" as a step in the simplification of the holding company structure, so that United shall cease to be a holding company as commanded by § 11(b)(2), and its stockholders shall become stockholders in its subsidiary, Railways Co. The Commission, in ordering dissolution and liquidation of the company, and providing for the distribution of its assets, found that the stipulated priority of the preferred stock is far in excess of the present value of the company's assets. It said that if the stipulated priority "is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common".

Nevertheless the Commission has ordered, and this Court sustains the order, that only 94.52% of the assets of the company be allocated to the preferred stock upon liquidation and 5.48% to the common. For purposes of liquidation the Commission measured the rights of the different classes of stockholders in terms of the estimated value of their interests as though the liquidation which the Commission had ordered were not to take place and the corporation were to continue as a going concern. In short, in liquidating the corporation it determined, as the opinion of the Court declares, that in distributing the assets of the corporation among its stockholders the rights of the stockholders "may be evaluated on the basis of a going business and not as though a liquidation were taking place".

Peering into the future with almost clairvoyant perceipience the Commission prophesied that if the company now being liquidated and dissolved were allowed to continue its operations it would, fifteen years hence, have paid all arrears of dividends on the preferred and would then be able to pay an estimated annual return on the common stock in excess of $2,500,000. This prophecy

assumed average future earnings in excess of $6,000,000 a year, a sum which "actual earnings . . . have never in the past ten years exceeded . . . , except in 1942". This prognosis, the Commission thought, afforded justification for distributing the assets of the corporation upon its liquidation and dissolution, not according to the stipulated priority of the preferred stock upon liquidation, which is in fact taking place, or indeed in conformity to its priority right to current earnings if the company were to continue unliquidated. For by the Commission's order the preferred is required to surrender to the common what is the equivalent of more than 5% of its fixed priority right to the annual earnings from the assets of the company, which earnings of a "going business" would be required to satisfy dividends on the preferred before any payment of dividends on the common. The preferred stockholders are thus denied the priority for which they have stipulated on liquidation, and also the priority with respect to current earnings to which they would be entitled by virtue of their position as preferred stockholders if the company, which has been in fact condemned to death by the Commission, is, as the Commission at the same time supposes, to be regarded as living and functioning as "a going business".

The judgment of the court below sustaining so extraordinary a result should, in our opinion, be reversed because the Commission, without authority in law and contrary to the command of the statute, has disregarded the plain terms of the corporate charter controlling priority of the preferred stock upon liquidation of the company whether voluntary or involuntary.

The opinion of the Court adopts for its support a ground which the Commission declined to adopt, and the decision of the Commission rested upon a second ground on which the Court appears not to rely. We think it clear that neither ground is supportable. The first is that the charter provision fixing the priority of the preferred stock in the event of "liquidation" was not intended to apply and is inapplicable to a "liquidation" like the present. For here, it is insisted, the liquidation, which has in fact been ordered and is being enforced, is nevertheless to be regarded as a fiction, and the interests of the different classes of stockholders are to be measured by resort to the fiction that they are continuing interests in a corporation which is not to be liquidated, but is to be continued as a going concern. The other ground, adopted by the Commission, is that if the charter provision does apply the Com-

mission is free to override it by any plan of distribution which it finds to be "fair and equitable".

As to the first it is plain that the company is now being liquidated and dissolved; that the liquidation is involuntary; and that some of the corporation's assets are being distributed to the common stock before satisfaction of the stipulated priority of the preferred, and this with full knowledge of all concerned that the company is without assets to satisfy the priority. Since these are the precise conditions on which the priority provision was, according to its terms, to operate, it is not apparent why this "liquidation" is not a "liquidation" within the meaning of the charter provision.

It is said that although the liquidation is involuntary, it is not within the charter provision, and that the stipulation for priority on liquidation may be disregarded because the Holding Company Act was enacted after the adoption of the charter, and hence the parties to the incorporation could not have contemplated a compulsory liquidation under its provisions. We find it difficult to suppose that a stockholder who stipulates for priority upon liquidation, whether voluntary or involuntary, is at all concerned with the particular source of the power which may compel the liquidation of his investment or with the purpose of its exercise. Unless words have lost their meaning, the stipulation for priority in this case cannot fairly be taken not to include any kind of a liquidation which would compel the surrender of the stockholder's investment and force him to sever his connection with the corporation in which he has invested.

When the preferred stock of United was issued in 1929 there were numerous statutes, state and federal, which authorized liquidation and dissolution of corporations by government compulsion. See for example *Continental Insurance Co.* v. *United States*, 259 U. S. 156. It is the veriest fiction to say that investors in corporate securities at that time could not or did not consider the possibility of the addition of a single statute to this list, or that the stockholders of United by the stipulation for priority upon liquidation, voluntary or involuntary, intended to exclude from its operation any method of involuntary liquidation which would affect their interests. To conclude that the present stipulation for priority upon involuntary liquidation did not envisage a liquidation such as this one seems like saying that an insurance policy payable on the death of the insured creates no obligation if the insured dies from a disease which was unknown when the policy was written.

We cannot assent to the proposition advanced by the Commission that even though the priority stipulation was intended to be applicable to any kind of an involuntary liquidation, including one such as the present, the Commission can nevertheless override it. Such provisions for priority in a corporate charter constitute a contract among the stockholders, which is entitled to constitutional protection, *Bedford* v. *Eastern Building & Loan Ass'n*, 181 U. S. 227; *Hopkins Federal Savings & Loan Ass'n* v. *Cleary*, 296 U. S. 315; *Treigle* v. *Acme Homestead Ass'n*, 297 U. S. 189, 194-6, impairment of which is not lightly to be attributed to Congress. No constitutional issue is raised here, but we find no provision of the statute which purports to confer on the Commission, in the exercise of its power to liquidate a corporation, any authority to set aside a lawful stipulation in which the stockholders have joined fixing their relative rights in the event of liquidation.

On the argument of this case counsel for the respondent referred to the Commission's action in setting aside the contract as an exercise of its power to "remold" the contract. Whether this characterization of the Commission's action may be thought to render it more palatable to the preferred stockholders whose lawful contract has been set aside by the Commission, it is plain that in the absence of some controlling direction of the statute there are no circumstances here which call for the exercise of any implied power of the Commission or court to readjust or restate the rights of the stockholders without regard to their contract. There is no suggestion that the present stipulation is unlawful, oppressive or inequitable, or subject to any other infirmity; or that it is incapable of being carried out in the present liquidation to which it applies. Hence there is no basis for the exercise of equity powers to adjust the rights of parties to a contract which has been set aside; or for the Commission's argument, which the Court of Appeals below seems to have sustained, 142 F. 2d 411, 419, that the action of the Commission is supportable as an exercise of the judicial power to make an equitable disposition of the rights of the parties to a frustrated contract. Cf. *New York Trust Co.* v. *Securities and Exchange Commission*, 131 F. 2d 274.

So far as the Commission has authority to liquidate any corporation, liquidation is only a step in the simplification of a holding company system or the elimination of an undesirable holding company, which are the avowed purposes of the Act. The Commission does not reveal how the distribution of the corporate as-

sets, upon which the stockholders have agreed, would hamper the simplification or the elimination of the liquidated company; or how the different distribution ordered by the Commission would facilitate them. It seems wholly irrelevant to the achievement of these, which are the avowed purposes of the Act, whether the stockholders of the dissolved corporation share in its assets in one proportion or another. Neither the Commission, the public, nor the stockholders have any ground for complaint so long as the agreed priority rights to the distributed assets remain unaltered.

The Commission has found its authority for setting aside the priority stipulation in the requirement of § 11(e) that the Commission must find that any plan it approves for elimination of a holding company is "fair and equitable". As we have already indicated, the Commission has said that it is "fair and equitable" to deprive preferred stockholders, in the event of liquidation, of the rights for which they have stipulated and paid in order to compensate the common stockholders for rights which they are said to have lost because of the liquidation. But such compensation of the common stockholders at the expense of the preferred is contrary to the priority stipulation by which both are bound. The common stockholders, like the preferred, have no right not to have the company liquidated and are entitled to no compensation merely because it is liquidated. Their rights as stockholders cannot survive liquidation and dissolution of the company, and in that event and because of it and because of the stipulation neither can assert rights which they could enjoy only if the corporation were to continue as a going concern.

We can find no basis for saying that it is not fair and equitable, both in a technical as well as a general and non-technical sense, to require the stockholders to abide by their agreement in the very circumstances to which it was intended to apply, and where, as we have said, there is no contention that the contract when made was or is now oppressive, unfair, inequitable or illegal. But beyond this we think it is quite clear that the requirement of § 11(e) that the plan be "fair and equitable", instead of furnishing authority for the deprivation of shareholders of their priority in liquidation, is a prohibition against it.

The phrase "fair and equitable" as applied to any form of corporate reorganization has long been recognized as signifying the requirement of the rule sanctioned by this Court in *Northern Pacific Ry.* v. *Boyd*, 228 U. S. 482, and the many cases following it. The rule is that any arrangement or plan enforced without

the consent of the parties affected by it, by which the subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights of other security holders, is unfair and inequitable and will not be judicially sanctioned. See *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, and cases cited. This rule is applicable with respect to the priorities of different classes of stockholders as well as to priorities between creditors and stockholders, and for the same reasons. *Case* v. *Los Angeles Lumber Co.*, *supra*, 119, note 14.

In the *Los Angeles* case, *supra*, we held that the words "fair and equitable" had so long been recognized and applied as signifying this rule of priority among security holders in corporate reorganizations as to have become words of art, and that their adoption by § 77 B of the Bankruptcy Act, as applicable to reorganizations under that section, must be taken to have incorporated the rule of the *Boyd* case in the statute, in the absence of any context requiring a contrary construction. We think no other construction of § 11(e) of the present Act can be sustained. Neither the context of the statute nor the legislative history suggests any other. The Commission hints at no reason for not giving these terms of art, "fair and equitable", other than their long settled and hitherto accepted meaning.

The Commission justifies its departure from the rule here only by recurrence in its brief to the proposition that "the essence of the reorganization process is the remolding of contract rights and the substitution therefor of equitable equivalents." To this the answer is that the Commission in this case is liquidating and dissolving, not reorganizing, United, and that it is without authority in such a case more than in a reorganization to alter or disregard a contract fixing the priorities of stockholders, and that in depriving the preferred stockholders of their priority rights the Commission has substituted no equivalent for them, either legal or equitable. In fact it has substituted nothing for the priority rights which its order destroys.

The Gold Clause Cases, *Norman* v. *B. & O. R. Co.*, 294 U. S. 240, afford no analogy and lend no support to what is now adjudged. There Congress, with the authority of an express provision of the Constitution, explicitly altered existing contracts. Here Congress has commanded the Commission to respect contract rights by requiring that its action conform to the well defined meaning of the phrase "fair and equitable". Congress seems to

have recognized that the stipulated priorities of stockholders were not to be disturbed in liquidations ordered under the Public Utility Holding Company Act. The report of the Senate Committee (S. Rep. No. 621, 74th Cong., 1st Sess., p. 33) recommending the enactment of the present statute and proponents of the Bill (H. R. Rep. 1318, 74th Cong. 1st Sess., pp. 49-50; 79 Cong. Rec. 4607, 8432) repeatedly cited *Continental Insurance Co.* v. *United States, supra*, in which it was held that the distribution in a liquidation compelled by the enforcement of the Sherman and Hepburn Acts must preserve the stipulated priorities of the several classes of stockholders of the offending corporation.

The intimation that the priority stipulation can be disregarded in the present liquidation because the Commission could have effected the simplification of the holding company structure by merger, consolidation or recapitalization, is merely to say that such procedure would not involve liquidation, voluntary or involuntary, or, what comes to the same thing, that the preferred stockholders could not claim the protection of the priority stipulation in situations to which it does not and was not intended to apply. By buying preferred stock the preferred stockholders paid for the privilege of membership in the corporation and for participation in the fruits of the corporate enterprise, to continue, with full priority of dividends so long as the corporation should continue as a going concern. But in the event of liquidation they stipulated and paid for the specified priority over the common stockholders in the distribution of the net corporate assets. The preferred stockholders here assert only the rights to which that stock is entitled on liquidation by the terms of the priority stipulation. Calling the preferred stockholders' right of priority a "windfall" will not serve as an apology, explanation, or justification for the Commission's action in appropriating the priority of the preferred in order to give a windfall to the common. It is no answer to say that their claim on liquidation might have been avoided by not liquidating or to say, as the Commission has ordered, that they must accept on liquidation less than their stipulated priority on liquidation and less than the rights to which they would have been entitled if the corporation had continued as a going concern.

The judgment should be reversed